

**THE STATE OF NEW HAMPSHIRE  
SUPREME COURT**

**CASE NO. 2012 – 0729**

**APPEAL OF THE LOCAL GOVERNMENT CENTER, INC. & a.**

**APPEAL BY PETITION PURSUANT TO RSA 5-B;4-a, VIII;  
RSA 541:6; AND SUPREME COURT RULE 10  
FROM A RULING BY THE BUREAU OF SECURITIES REGULATION**

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**APPELLANTS' BRIEF**

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(15 Minutes Oral Argument)

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**The Constitutional Provisions, Statutes, and Laws are reproduced in Appellants' Appendix due to their length.**

## QUESTIONS PRESENTED FOR REVIEW

1. RSA 5-B imposes few specific requirements on pooled risk management programs and leaves most decisions to the business judgment of their boards of directors. Does the Final Order (the “Order”) deprive Local Government Center, Inc. (“LGC”) of due process and otherwise err as a matter of law because it imposes requirements on LGC not stated in RSA 5-B or in any rule and announced for the first time following an adjudicatory hearing, including specific limits on reserves and a proscription on LGC’s HealthTrust risk pool’s strategic support to LGC’s Workers’ Compensation risk pool, and ignores the business judgment rule? APApp.<sup>1</sup> 90-107, 113-115, 117-8.

2. Was it an unconstitutional retroactive application of RSA 5-B for the Presiding Officer to undo transfers from LGC’s other risk pools to LGC’s Workers Compensation risk pool when the transfers were executed before the Secretary of State (the “Secretary”) obtained regulatory authority over RSA 5-B risk pools in June 2010? APApp. 116-117.

3. Did the Presiding Officer deprive LGC of due process by declining to disqualify himself based on his direct and indirect pecuniary interest in the proceeding because he was unilaterally hired and paid by the Secretary, his compensation was based on the duration of the matter, and he renegotiated his contract with the Secretary at least twice during the proceeding, including during the adjudicatory hearing? APApp. 85-90.

4. Did the Presiding Officer err as a matter of law in ordering LGC to pay all of the Secretary’s costs and attorneys’ fees, when one count of the Amended Petition was dismissed before the adjudicatory hearing, LGC prevailed on three of the five counts at the hearing, and the individual respondents prevailed on all of the counts against them? APApp. 120.

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<sup>1</sup> The Appendix to LGC’s Appeal by Petition is referred to as “APApp.” The Appendix to LGC’s brief is referred to as “App.” The adjudicatory hearing transcripts are referenced as “Tr.” Hearing exhibits are referenced as “Ex.”

## STATEMENT OF THE CASE

This case concerns LGC's administration of its pooled risk management program and associated risk pools, which it has operated since 1987. In 2010, the Secretary obtained jurisdiction to regulate risk pools under RSA 5-B. In 2011, the Bureau of Securities Regulation (the "Bureau") filed a petition with the Secretary charging LGC with violations of the statute. After a 10-day hearing in May 2012 (the "Hearing"), the Presiding Officer found that LGC had violated reserve and other requirements said to be found in RSA 5-B. LGC appealed, arguing that: (a) the Order's requirements have no basis in RSA 5-B or rules promulgated under the statute; (b) the Order fails to apply the business judgment rule to the actions of LGC's Board of Directors; (c) the Order retroactively applies RSA 5-B to conduct that occurred before the Secretary obtained jurisdiction to enforce the statute; and (d) the Presiding Officer should have disqualified himself due to his pecuniary interest in the duration and outcome of the proceeding.

## STATEMENT OF THE FACTS

### **I. LGC and the Amended Petition**

LGC is a non-profit corporation, governed by a Board of Directors made up of municipal, school, and county representatives, including public officials and employees. LGC (including its HealthTrust and Property-Liability Trust risk pools) is a voluntary association of political subdivisions of the state and their instrumentalities, whose members agree to be bound by the voluntary association's bylaws. HealthTrust covers more than 70,000 individual public employees, their dependents, and retirees, with 36 medical plans and 25 prescription drug plans. HealthTrust handles approximately \$360 million in claims each year. Property-Liability Trust covers over 4,000 buildings and their contents with a value of nearly four billion dollars in its

Property-Liability risk pool, and also covers 26,000 public employees in its Workers' Compensation risk pool.

Until 2009, RSA 5-B:4 expressly provided that “[n]othing contained in this chapter shall be construed as enabling the department [of State] to exercise any rulemaking, regulatory or enforcement authority over any pooled risk management program . . . .” The statute was amended effective June 14, 2010, giving the Secretary the power to regulate RSA 5-B entities. *See* RSA 5-B:4-a. Although the Secretary did not promulgate rules after the 2010 amendment, the Bureau filed a Staff Petition against LGC in September 2011 that alleged violations of purported requirements of RSA 5-B and RSA 421-B. App. 53-106. The petition was amended in February 2012. The Amended Petition alleged that LGC’s reserve levels and method of returning surplus violated RSA 5-B, that its strategic support of the Workers’ Compensation risk pool violated the statute, and that LGC and individual respondents had violated New Hampshire securities laws. App. 107-144.

## **II. Reserves and Return of Surplus**

### **A. Statutory requirements**

A risk pool’s governing board shall “provide for an annual actuarial evaluation” that “shall assess the adequacy of contributions required to fund any such program and the reserves necessary to be maintained to meet expenses of all incurred and incurred but not reported claims and other projected needs of the plan.” RSA 5-B:5, I(f). The evaluation “shall be performed by a member of the American Academy of Actuaries qualified in the coverage area being evaluated . . . .” *Id.* The Bureau’s actuary acknowledged that HealthTrust met these requirements. Tr. 753-59 (App. 382-89). The Bureau’s actuary also acknowledged that RSA 5-B “does not specify any specific actuarial method to calculate reserves.” Tr. 707 (App. 366); *see* RSA 5-B:5, I.

RSA 5-B:5, I (c) requires risk pools to “return all earnings and surplus in excess of any amounts required for administration, claims, reserves, and purchase of excess insurance.” In 2010, the legislature directed that a consultant be retained to make a recommendation to it about the maximum level of risk pool reserves. Tr. 711 (App. 367). The recommendation remains pending. Tr. 713-14; 732 (App. 369-70; 372). Legislation was introduced in 2010 to mandate reserve levels, but the proposed bill failed to pass. Tr. 737-738 (App. 377-78).

**B. The Board of Directors and LGC’s reserves**

LGC’s Board of Directors played an active role in setting rates and reserve levels with the advice of its qualified actuary and other professionals. The outside actuary for HealthTrust, Peter Riemer, characterized the Board as “keenly interested” in the questions of surplus and capital reserves. Tr. 1257-58 (App. 401-02); *see also* Tr. 1273 (capital adequacy “continuous item of interest,” on which Riemer gave regular updates and detailed presentations) (App. 405); LGC Ex. 177. LGC’s corporate counsel characterized the Board as being “very careful,” focused on being “compliant with good corporate governance as well as [the] statute,” and understanding the issues related to pooled risk management programs. Tr. 1569-71.

LGC’s rate-setting process begins with staff-level consultation amongst its staff, its actuary, and actuaries for Anthem. Tr. 1398-99 (App. 415-16). Recommendations are made to the Board’s Finance Committee, where there is significant discussion and debate. Tr. 1404-05 (App. 417-18); *see, e.g.*, LGC Exs. 115, 119, 125. A public hearing is held. Tr. 1405 (App. 418). The Board then meets to discuss rates and return of surplus. Tr. 1407-09 (App. 419-21). Often, the meetings are “intense,” with “very differing opinions on the Board[.]” Tr. 1409 (App. 421). Directors pay special attention to this process, in part, because many are public officials who must justify rates to their communities. Tr. 1409-10 (App. 421-22).

When setting reserve levels, the Board relies on the advice of its outside actuary, legal counsel, and other experts. *See* Tr. 1573-74 (App. 431-32). LGC has an attorney at every Board, committee and pertinent staff meeting to ensure compliance with the law and to answer Directors' questions. Tr. 1567 (App. 427). Each year LGC's attorney reviews with the directors their statutory and fiduciary obligations under RSA 5-B, including the provisions pertaining to surplus. Tr. 1205-06 (App. 396-97); *see, e.g.*, LGC Exs. 087, 112, 122, 130.

The Board relied on its actuary's analysis in selecting the "risk-based capital" or "RBC" method for setting reserves and a target RBC ratio of 4.2.<sup>2</sup> Tr. 2340 (App. 450); *see, e.g.*, LGC Exs. 34 & 36. The Board revisits its reserve level target annually to ensure that it remains appropriate. Tr. 1616 (App. 436). LGC's actuary testified that its "target capital levels" are "reasonable, prudent, and necessary for the successful operation of the program." Tr. 1252 (App. 400); *see also* Tr. 1317 (App. 412). LGC does not always hit its RBC target with precision, as RBC ratios fluctuate with membership levels and claims experience. Tr. 2366-67 (App. 468-69); *see also* Tr. 1286-88 (App. 406-08).

### **C. Industry standards**

The Bureau's actuary acknowledged that "RBC is the *de facto* standard for measuring the adequacy of reserves for health insurance entities." The Bureau's industry expert conceded that RBC is a "perfectly acceptable method" for determining the adequacy of LGC's capital. Tr. 321 (App. 360); Tr. 752 (App. 381). LGC selected its 4.2 RBC target "after reviewing the level other health insurers maintain," including Blue Cross and Blue Shield, and "the RBC level of health insurers with similar asset levels to LGC HealthTrust." BSR Ex. 69; LGC Ex. 159. In connection with the adoption of the RBC target in 2002, LGC's actuary "presented comparison

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<sup>2</sup> RBC is a method of measuring the proper minimum amount of capital for an entity to support its overall business operations in consideration of its size and risk profile. It is commonly used in the health insurance industry.

data on levels that other insurers were holding, which were generally higher—much higher than 2.0 and certainly higher than the 4.20 that was provisionally adopted.”<sup>3</sup> Tr. 1262-63 (App. 403-04). Indeed, a document the Bureau submitted to the Legislature declared that an RBC of 4.2 “is not out of line with the range of RBC ratios used in other jurisdictions.” Tr. 745 (App. 380); LGC Ex. 362 (Bureau’s “*Recommendations Concerning the Limitation of Reserves . . . of Pooled Risk Management Programs*”) (App. 350-56); *see also* LGC Ex. 356 (*Study of the Reserves and Surpluses of Health Insurers in Massachusetts*, recommending an upper threshold for reserves between an RBC of 7.0 to 9.0). The Board chose 4.2 because it was an acceptable mid-point. Tr. 2339-40 (App. 465-66).

#### **D. Return of surplus**

LGC has been returning surplus to its members via rate reduction to stabilize rates since 1996. Tr. 1487-88 (App. 425-26); *see also* Tr. 817 (bylaws governing HealthTrust since at least 1999 have said “return may be by means of reduction in contributions due in the subsequent fund year” unless a member elects otherwise) (App. 391). LGC’s Executive Director testified that members prefer this method of return: “The information that I had received both from members of the board and members of local officials in our member communities was that . . . our members . . . saw the benefit of returning surplus through rate stabilization.” Tr. 1843 (App. 441). HealthTrust at one time returned surplus to its members via dividends, but was “told by the members, don’t ever do that again to us.” Tr. 2380 (App. 472). Board member Peter Curro explained that rate stabilization “avoid[s] what’s termed as spikes . . . in the rates,” and “makes it a whole lot easier” for members to budget. Tr. 2381 (App. 473); *see also* Tr. 1446-47 (rate stabilization benefits members) (App. 423-24). The Bureau offered no contrary evidence.

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<sup>3</sup> RBC 2.0 is the level at which regulators question the solvency of insurance carriers. Tr. 84-5.

After being advised by its outside corporate counsel that RSA 5-B allowed it, Tr. 1616-20 (App. 436-40); LGC Ex. 381, LGC's Board opted to return surplus to members over multiple years via rate reduction, Tr. 2381 (App. 473), consistent with other risk pools across the nation. Tr. 1605 (App. 435).

### **III. Workers' Compensation Support**

Before a 2003 corporate reorganization put a single Board of Directors in charge of LGC's risk pools, independent boards administered the HealthTrust and Workers' Compensation pools.<sup>4</sup> The HealthTrust board first voted in 1999 to support the Workers' Compensation risk pool, having determined that it would benefit HealthTrust, in part on the belief that PRIMEX, a competing risk pool operator, was denying legitimate workers' compensation claims which then were passed on to health insurers such as HealthTrust. LGC Exs. 3 (App. 220-25), 7 (App. 226-32). The HealthTrust board expected to achieve a minimum of 8 to 14 percent, LGC Ex. 2, p. 1 (App. 215), and perhaps 20 to 30 percent, in cost savings by supporting the Workers' Compensation risk pool. LGC Ex. 7, p. 4 (App. 229). HealthTrust continued the policy into 2004, and thereafter LGC's Board of Directors continued it. Tr. 2351 (App. 467); *see also* Tr. 2392-93 (App. 474-75); LGC Ex. 62 (App. 233-38).

The Board viewed its strategic support of the Workers' Compensation risk pool as part of a "long-term vision of integrated risk management and health management for employees." *See* LGC Ex. 425 ("Through a combination of Workers' Compensation programs, short and long-term disability benefits, and health benefits, LGC's members ... essentially are financially responsible for the total health of the people they employ and their families.") (App. 255); *see also* LGC Exs. 62 (App. 233-38), 63, 67-8, 70. For example, the Board concluded that training

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<sup>4</sup> The independent boards of directors that had governed HealthTrust, Property-Liability Trust, and New Hampshire Municipal Association voted in 2003 to restructure under a single LGC board of directors. LGC Exs. 45, 47, 48.

in proper lifting techniques or safe driving might reduce workers' compensation claims and also help prevent back injuries and car accidents off the job, thereby reducing health and disability claims and lost work time. LGC Ex. 425 (App. 255). The Board thus "envisioned a strong, viable Workers' Compensation program to be an integral complement to the HealthTrust coverage with a resulting benefit to the health and welfare of employees and their families and to the finances of LGC members and their taxpayers." *Id.*

#### **IV. Other Facts Relevant to the Appeal**

RSA 5-B does not require risk pools to purchase reinsurance; its purpose is to facilitate "insurance by self-insurance." RSA 5-B:3, I. The statute mentions reinsurance as a cost that *may* be incurred. *See* RSA 5-B:5, I(c)) ("*any* amounts required . . . for purchase of excess insurance") (emphasis added). By maintaining reserves at a sufficient level, LGC saved its members money by avoiding the need to purchase reinsurance. Tr. 2238-43 (App. 448-53).

RSA 5-B:5, I(c) permits risk pools to retain "any amounts required for administration," without further elaboration. The Bureau's actuary examined HealthTrust's administrative expenses—approximately 7.7 percent of claims—and found them to be reasonable. Tr. 733-35 (App. 375-77). Indeed, LGC's administrative expenses were more than two percent below a proposed "10 percent of total claims" cap the Bureau had recommended to the Legislature. Tr. 735-36 (App. 377-76).

#### **V. The Secretary and the Presiding Officer**

After receiving the Staff Petition, the Secretary issued a cease and desist order, and unilaterally selected the Presiding Officer to adjudicate the matter without creating a record of the selection process. Seeking assurance that an impartial person would be appointed, LGC suggested a retired judge or justice and offered to pay half of the cost; the Secretary rejected the

offer and instead appointed a former state employee. Respondents' Memorandum in Support of Oral Motion for Withdrawal of Presiding Officer ("Withdrawal Motion"), p. 4 (App. 148).

When the Secretary asked the Presiding Officer to work without pay, the Presiding Officer—who described himself as “not a person of significant wealth”—declined. Tr. 2314-15 (App. 460-61); Withdrawal Motion, Ex. B, p.7 (App. 166). While the Presiding Officer's contract with the Secretary provides for his pay to be equivalent to his last state compensation, *id.* at 6 (App. 165), he was actually paid substantially more than his former state salary.<sup>5</sup> A contract provision exempts it from the usual Governor and Executive Council review.

When LGC inquired of the Presiding Officer about his contract early in the proceeding, it was informed that it was a “flat basis” or flat fee contract.<sup>6</sup> Tr. 2306, 2311, 2313 (App. 457; 458; 459). In fact, the contract provided for the Presiding Officer to be paid \$5,000 bi-weekly based on the duration of the matter (up to a “not to exceed” amount). After LGC had so inquired, the Presiding Officer twice renegotiated his contract with the Secretary, once during the Hearing, to increase the not-to-exceed amount due to the duration of the matter. These renegotiations were conducted off the record and without LGC's knowledge.<sup>7</sup>

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<sup>5</sup> According to the website maintained by the New Hampshire Department of Administrative Services and the Department of Information Technology, in consultation with the legislative oversight committee established by Chapter 65 - Laws of 2010, [www.nh.gov/transparentnh](http://www.nh.gov/transparentnh), the Presiding Officer was paid a total of \$129,209.21 for the proceeding. *See* Secretary of State Vendor - Donald E Mitchell FY 2012 and 2013). His salary for his last year as Executive Director of the NH PLRB in 2009 was only \$89,775.75. *See* Withdrawal Motion, Ex. B, at 6-7 (App. 165-66). His original contract with the Secretary had a “not to exceed” limit of \$30,000, a completion date of November 30, 2011, and required him to submit semi-monthly invoices “for services rendered.” *Id.* at 1, 6 (App. 160, 165). The \$30,000 was later increased to \$90,000, and the completion date was moved to May 30, 2012. *Id.* at 8 (App. 167). The Presiding Officer submitted invoices for “personal services rendered” every half-month in the amount of \$5,000.00, plus mileage. *Id.* at 23-39 (App. 182-198). The Presiding Officer's former state salary of \$89,775.75 would have produced monthly income on the order of \$7,481.31. The \$10,000-per-month he received in this case exceeded his 2009 state salary by almost thirty-four percent.

<sup>6</sup> A “flat fee” is commonly understood to mean a set amount to be paid independent of time expended or the duration of the engagement. *See, e.g.*, N.H. Rules Prof. Conduct 1.15(d), NH Ethics Committee Comment.

<sup>7</sup> Speaking with counsel on the penultimate hearing day, the Presiding Officer noted that he needed to “renegotiate” his contract due to the length of the hearing. LGC moved to disqualify him the next morning. Tr. 2305 (App. 456).

Before the final hearing, LGC and the other Respondents filed motions to dismiss the Amended Petition. The Presiding Officer denied the motions. Had he granted them, the Presiding Officer would have been paid tens of thousands of dollars less than he received by allowing the case to proceed. During the Hearing, at its first opportunity upon discovering the terms of the contract and its ongoing renegotiation, LGC moved for the Presiding Officer's disqualification. Tr. 2305-6 (App. 456-57). The Presiding Officer denied LGC's motion and precluded LGC from inquiring about, responding to, or presenting further argument based on his comments. Tr. 2313-18 (App. 459-64). LGC then renewed its motions to dismiss. If the Presiding Officer had disqualified himself, he would have been paid thousands of dollars less than he received by remaining on the case to draft the Order.

#### **VI. The Bureau's agreements with other risk pools**

Shortly before the Hearing, the Bureau reached agreements with New Hampshire's other pooled risk management programs, PRIMEX and SchoolCare, regarding their future operations. The agreements permit these risk pools to use different methods for setting reserves, and to maintain different reserve levels. The Bureau's agreements with PRIMEX and SchoolCare allow their boards to set reserve levels based upon their "sound business judgment." *See* Tr. 1600-01 (App. 433-34); LGC Ex. 334 § 3.1 (Bureau's Risk Pool Practices Agreement with PRIMEX) (App. 258-275); BSR Ex. 65 § 3.2 (Bureau's Risk Pool Practices Agreement with SchoolCare) (App. 276-290).<sup>8</sup>

#### **VII. The Order**

The Presiding Officer ruled that LGC had violated RSA 5-B by failing to limit its reserves to the lesser of 15% of claims or an RBC ratio of 3.0, Order at 74-77, and by using

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<sup>8</sup> While the PRIMEX agreement establishes an initial reserve limit of 3.0 RBC, it allows PRIMEX to exceed a 3.0 RBC based on the business judgment of its board of directors.

HealthTrust funds to strategically support its Workers' Compensation risk pool, *id.* at 78-9. He ordered LGC to annually return excess reserves to its members in cash, *id.* at 75-6; to purchase reinsurance, *id.* at 75; to undo financial transfers made before the Secretary obtained regulatory authority over risk pools, *id.* at 78-9; to treat certain capital assets essential to the operation of its risk pools as excess reserves to be returned to its members, *id.* at 43-4; that certain expenses LGC had incurred were not permitted by the statute, *id.* at 43-4; and to pay all of the Bureau's costs, *id.* at 80;. The Presiding Officer ruled for LGC on the securities claims, and dismissed all the counts against the individual respondents. *Id.* at 70.

Based upon these rulings, the Presiding Officer ordered that HealthTrust return \$33.2 million held in reserves to its members; that Property-Liability Trust return \$3.1 million to its members; that Property-Liability Trust transfer \$17.1 million to the HealthTrust risk pool as return of strategic support HealthTrust had provided to the Workers' Compensation risk pool since 2000; and that HealthTrust spend millions of dollars to purchase reinsurance, despite the decision of LGC's Board of Directors to less expensively self-insure against unexpected losses.

LGC filed a Motion for Reconsideration and a Motion to Stay the Order with the Presiding Officer. The Presiding Officer denied both motions.<sup>9</sup> This appeal followed.

### **SUMMARY OF ARGUMENT**

RSA 5-B is broadly worded to allow risk pool programs wide authority to govern themselves, RSA 5-B:5,I(b), and to operate their risk pools "for the benefit of political subdivisions." RSA 5-B:3,III. Accordingly, the statute imposes few specific requirements on pooled risk management programs and leaves most decisions to the business judgment of their boards of directors. The Presiding Officer's Final Order violates LGC's constitutional right to

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<sup>9</sup> The Order included provisions mandating certain corporate reorganization steps to be taken by LGC. Though included in the original Appeal by Petition, LGC has since complied with these provisions and takes no further appeal from those portions of the Order.

due process because it imposes new requirements on LGC not stated in RSA 5-B or in any rule and announced for the first time following the adjudicatory hearing. Even if the Presiding Officer's actions are not unconstitutional, he otherwise erred as a matter of law because the requirements he imposed on LGC are unsupported by RSA 5-B and were arrived at because the Presiding Officer ignored the business judgment rule.

The Presiding Officer's misinterpretation of RSA 5-B and his disregard for the business judgment rule are evident in his rulings that: LGC must set its reserves at 15% of claims or an RBC ratio of 3.0 (RSA 5-B neither references such standards nor provides other guidance as to how or at what level reserves must be set); LGC must return surplus annually in cash, instead of via rate stabilization over one or more years (RSA 5-B:5,I(c) requires risk pools to return surplus to their members, but does not specify a required method of return); capital assets necessary to operate a risk pool should be viewed as excess reserves to be returned to members; LGC must purchase reinsurance immediately (RSA 5-B:5,I(c) authorizes self-insurance and lists reinsurance ("excess insurance") as a cost that *may*, not *must*, be incurred); LGC's decision to create an employee retirement program somehow demonstrates that its reserves were excessive (RSA 5-B:5,I(c) allows risk pools to retain "any amounts required for administration"); and HealthTrust's strategic support for the Workers' Compensation risk pool was unlawful (RSA 5-B:3,I permits political subdivisions to "provide for pooling of self-insurance reserves, risks, claims and losses, and of administrative services and expenses associated with them among political subdivisions.").

When the Presiding Officer ordered that LGC undo transfers from HealthTrust in strategic support of LGC's Workers' Compensation risk pool that occurred between 2004 and 2010, it was an unconstitutional retroactive application of RSA 5-B. Until 2009, RSA 5-B:4

expressly prohibited the Secretary from exercising regulatory authority over RSA 5-B risk pool programs. On June 14, 2010, RSA 5-B:4-a first gave the Secretary “the power to investigate pooled risk management programs, issue cease and desist orders, initiate adjudicatory proceedings, impose administrative fines, and order rescission, restitution, or disgorgement.” Thus, the majority of the transfers occurred before the Secretary had jurisdiction over risk pools.

LGC also was denied due process when the Presiding Officer failed to disqualify himself based on his direct and indirect pecuniary interest in the proceeding. The Presiding Officer was unilaterally hired and paid by the Secretary, his compensation was based on the duration of the matter, and potentially its outcome, and he renegotiated his contract with the Secretary at least twice during the proceeding, including during the adjudicatory hearing.

Finally, the Presiding Officer erred when he ordered LGC to pay all of the Secretary’s costs and attorneys’ fees when the Bureau did not prevail on a majority of the counts.

### ARGUMENT

- I. The Presiding Officer violated LGC’s right to due process and fair notice, and erred as a matter of law by imposing new requirements on LGC that do not exist in RSA 5-B or in any rule or regulation and were announced for the first time in the Order, and by ignoring the business judgment rule.**
  - A. The Presiding Officer violated LGC’s constitutional right to due process and fair notice.**

RSA 5-B imposes only two reserve-related requirements on pooled risk management programs. It is undisputed that LGC has complied with the first requirement that risk pools “[p]rovide for an annual actuarial evaluation of the pooled risk management program.” RSA 5-B:5, I(f); *see*, LGC Ex. 306 at 45-55 and LGC Ex. 302 at 93-126; Tr. 753-759 (App. 382-88).

Risk pools also must “[r]eturn all earnings and surplus in excess of any amounts required for administration, claims, reserves, and purchase of excess insurance to the participating political subdivisions.” RSA 5-B:5, I(c). In 2011, the Bureau declared that LGC’s reserves

violated the statute and the Presiding Officer subsequently enforced the Bureau's declaration. The statute does not require, however, that LGC set its reserves at 15% of claims or an RBC ratio of 3.0, the level established by the Presiding Officer. In fact, RSA 5-B neither references such standards nor provides other guidance as to how or at what level reserves must be set. Instead, as detailed below, the statute leaves the setting of reserve levels to the business judgment of a risk pool's board of directors. Consequently, the Presiding Officer violated LGC's right to due process and fair notice when he imposed standards of which LGC was not afforded notice. See U.S. Const. amend. V; N.H. Const. part I, article 15.

It violates due process and fair notice for a quasi-judicial officer to sanction a party in an adjudicative proceeding for having violated standards that are unknown because they do not exist in a statute or rule. See *Nevins v. N.H. Dep't of Resources and Economic Dev.*, 147 N.H. 484, 487 (2002) ("One purpose for requiring rules is to give persons fair warning as to what standards the agency will rely on when making a decision."). Although "promulgation of a rule . . . is not necessary to carry out what a statute demands on its face[.]" *Appeal of Blizzard*, 163 N.H. 326, 330 (2012) (quoting *Nevins*, 147 N.H. at 487), "[i]f the statute lacks sufficient detail on its face" to support an agency action, "then an agency must adopt rules supplying the necessary detail." *Id.* Absent agency rules, the Court must "determine whether the result [of the agency's failure to adopt rules] was unfair by examining whether the complaining party 'suffered harm as a result of the lack of [required] rules.'" *Id.* (quoting *Nevins*, 147 N.H. at 488).

RSA 5-B lacks sufficient detail on its face to support the specific standards created by the Presiding Officer. See *Blizzard*, 163 N.H. at 330. In 2010, the legislature acknowledged that RSA 5-B:5 lacks sufficient detail to dictate that certain conduct is prohibited when it directed the Secretary to engage a consultant and submit a report containing recommendations for the

maximum level of reserves to be held by pooled risk management programs and limitations on administrative expenses as a percentage of claims. Ch. 149:6, Laws of 2010 (App. 10-53). The requested report was submitted, but no action has been taken by the legislature. Tr. 711, 713-14, 732 (App. 367, 369-70, 372). This legislative action demonstrates that the statute lacks sufficient detail to support the requirements the Presiding Officer imposed on LGC.

Unlike the situations in *Blizzard*, 163 N.H. at 330, and *Nevins*, 147 N.H. at 488, LGC suffered direct and substantial harm due to the Bureau's failure to promulgate regulations. LGC has for years operated in reliance on its reasonable determination that it was in compliance with RSA 5-B:5, I(c), which simply requires it to "[r]eturn all earnings and surplus in excess of any amounts required for administration, claims, reserves, and purchase of excess insurance" to its members. Without notice, LGC has been subjected to the disruption and expense of an enforcement action, and required to pay more than \$50 million. The Bureau should not be permitted to hold LGC to standards that are neither expressed nor implied in RSA 5-B, nor established via rulemaking. It has engaged in *ad hoc* rulemaking that violates due process.<sup>10</sup>

**B. The Presiding Officer erred as a matter of law by broadening the scope of the statute and failing to apply the business judgment rule when he imposed requirements on LGC not found in RSA 5-B.**

**1. The requirements imposed in the Order are not found in RSA 5-B.**

Even if the Presiding Officer's actions are not unconstitutional, the requirements he imposed on LGC are unsupported by the statute he purports to interpret. Statutory interpretation is an issue of law this Court reviews *de novo*. *Carparco v. Town of Danville*, 152 N.H. 722, 725-26 (2005). This Court "is the final arbiter of the meaning of a statute as expressed by the words

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<sup>10</sup> The Presiding Officer's disregard for due process also is evident from the Order barring LGC from requiring membership and/or payment of dues as a precondition to participation in its risk pools. See Order at 74, ¶4. Although this issue was raised in the Staff Petition, the Bureau dropped it from the Amended Petition and did not raise it at the Hearing. Consequently, LGC lacked notice that it needed to offer evidence on the issue.

of the statute itself.” *Weare Land Use Assoc. v. Town of Weare*, 153 N.H. 510, 511-12 (2006). The Court “first examine[s] the language of the statute, and, where possible . . . ascribe[s] the plain and ordinary meanings to the words used.” *Carparco*, 152 N.H. at 725. Importantly, the Court “will not consider what the legislature might have said nor add words that it did not see fit to include.” *State v. Duran*, 158 N.H. 146, 155 (2008)(citations omitted).

RSA 5-B authorizes the Secretary to exercise certain supervisory powers. The Secretary may issue a cease and desist order when “any person has engaged or is about to engage in any act or practice constituting a violation of this chapter,” RSA 5-B:4-a, VI, and may “enter an order of rescission, restitution, or disgorgement directed at a person who has violated this chapter, or rule or order under this chapter.” RSA 5-B:4-a, VII(b). The Secretary’s authority, however, is not unlimited. It is restricted to “powers specifically granted or reasonably implied in order to perform the substantive responsibilities imposed by this chapter.” RSA 5-B:4-a.

Administrative acts “may not add to, detract from, or modify the statute which they are intended to implement.” *In re Anderson*, 147 N.H. 181, 183 (2001)(quotations omitted); see, e.g., *In re Wilson*, 161 N.H. 659, 662 (2011). Thus, a hearing officer’s role is designed to “only fill in the details to effectuate the purpose of the statute.” *In re Anderson*, 147 N.H. at 183.

Where the statute mandates specific remedies, a hearing officer cannot dictate terms that broaden the scope of the statute or change its terms in a manner that contravenes its intent, *In re Mays*, 161 N.H. 470, 476 (2011), thereby becoming a one-person legislative body. *See E.D. Swett, Inc. v. N.H. Comm. For Human Rights*, 124 N.H. 404, 412 (1983) (no administrative authority to award certain damages because “express indication from the legislature” lacking).

RSA 5-B:3, III provides that governmental entities may form or join risk pools “to develop and administer a risk management program” having many important roles, namely:

“reducing the risk of its members; safety engineering, distributing, sharing and pooling risks; acquiring insurance, excess loss insurance, or reinsurance; and processing, paying and defending claims against the members . . . .” The statute also allows risk pools to provide a variety of coverages, but does not mandate a specific structure to provide those coverages. *Id.* While there are certain standards and organizational minimums each pool is required to meet, the standards are expressed in broadly worded terms. *Id.* Thus, while each pool “shall . . . [r]eturn all earnings and surplus in excess of any amounts required for administration, claims, reserves, and purchase of excess insurance to the participating political subdivisions[.]” RSA 5-B:5, I(c), the legislature established neither a minimum level of reserves or returns, *see* Tr. at 659 (National Association of Insurance Commissioners’ minimum required reserves) (App. 365), nor maximum, *see* Tr. at 1289-91 (maximum capital requirements enacted by other states) (App. 409-11). Neither did the legislature set a single method to pay claims, standardize administrative cost maximums, or establish an accounting method to determine appropriate reserve levels. *Id.*

It is not a matter of neglect. The Legislature held extensive hearings on the proper level of reserves in the 2010 legislative session. During the Senate hearings, the Bureau admitted that RSA 5-B does not establish an amount or a formula for setting an amount for a risk pool’s reserves. LGC 253, p. 2 (Testimony of BSR Staff Attorney Kevin Moquin: “[W]e do support the concept of providing a specific benchmark for reserves. It doesn’t seem unreasonable to us that the Legislature should set a reserve level for the program the Legislature authorized, and it would give us further guidance as to what the Legislature considers a proper level of reserves.”) (App. 334). Despite Attorney Moquin’s testimony, the legislature chose not to limit the amount of reserves a pool could maintain. *See* Laws 2010, 149:6 (App. 10-43). Instead, it commissioned a study to advise it whether to mandate a specific method to calculate reserves. Tr. 711-13 (App.

367-70); 731-32 (App. 371-72). Although recommendations later were made, not one has been adopted. Tr. 713; 732 (App. 370; 372).

Unlike the legislature, the Presiding Officer was not reluctant to mandate reserve levels, a single vehicle to return surplus, and reinsurance. In fact, he admitted to filling what he perceived as a legislative void. Order at 76-7, ¶¶ 9-10 (opining that the legislature should further address the issue of reserve levels, and until such time as they do, he will mandate reserves and further that any surplus be returned in cash annually). Even if an administrative body is of the opinion that certain acts must be undertaken, it is not the role of a Presiding Officer to impose that rule; rather, “the proper place for making such arguments is before the Legislature.” *Greenland Conservation Comm’n v. N.H. Wetlands Council*, 154 N.H. 529, 535 (2006).

For these reasons, the Presiding Officer erred when he imposed requirements on LGC that the legislature did not include in RSA 5-B, thereby unlawfully “extend[ing] the scope of the agency’s authority,” *id.at* 537, and misapplying the law. See, e.g., *In re Wilson*, 161 N.H. at 661.

**2. The Presiding Officer erred in imposing his own judgment and ignoring the sound business judgment of LGC’s Board of Directors.**

It is undisputed that LGC has calculated its reserves and returned surplus to its members; the issue at the Hearing was whether LGC maintained an *appropriate level* of reserves and returned an *appropriate amount* of surplus. Rather than a statutory directive or rule setting a maximum reserve level, the breadth of RSA 5-B:5 requires a risk pool’s board of directors to exercise its business judgment to decide the appropriate level of reserves to hold to protect members against future risks. This is precisely what LGC’s Board of Directors has done.

In New Hampshire, the directors of a corporation must discharge their duties in good faith, with the care an ordinarily prudent person in a like position would exercise under similar circumstances and in a manner they reasonably believe to be in the best interests of the

corporation. RSA 293-A:8.30(a). The business judgment rule is “a powerful presumption in favor of actions taken by the directors in that a decision made by a loyal and informed board will not be overturned by the courts unless it cannot be ‘attributed to any rational business purpose.’” *Cede & Co. v. Technicolor, Inc.*, 634 A.2d 345, 361 (Del. 1993); *see also Unitrin, Inc. v. American General Corp.*, 651 A.2d 1361, 1373 (Del. 1995) (“The business judgment rule is a ‘presumption that in making a business decision the directors of a corporation acted on an informed basis, in good faith and in the honest belief that the action taken was in the best interests of the company.’”).

The burden is on the party challenging an exercise of business judgment to rebut the presumption in favor of directors who acted in good faith and exercised ordinary care. *McMullin v. Beran*, 765 A.2d 910, 917 (Del. 2000). The business judgment rule thus “operates to preclude a court from imposing itself unreasonably on the business and affairs of a corporation.” *Cede*, 634 A.2d at 360. The Presiding Officer erred when he substituted his judgment for the sound business judgment of LGC’s Board of Directors.

**C. The Presiding Officer’s constitutional violations, his disregard for the business judgment rule, and his corresponding misinterpretation of RSA 5-B are evident in no less than six specific areas.**

**1. Reserves**

Under RSA 5-B, it falls to the Board of Directors—exercising their sound business judgment—to establish an appropriate reserve level. Tr. 323 (App. 361). The Bureau’s own insurance industry expert, Michael Coutu, admitted that “[i]t’s [the Board’s] prerogative to set a [reserve] level they deem prudent.” *Id.* The Presiding Officer, however, failed to analyze LGC’s actions in setting reserves under that framework.

LGC set a target RBC ratio of 4.2. Tr. 788 (App. 389). LGC's realized RBC ratio for 2010, the last year that audited financial statements were available, was 4.3.<sup>11</sup> As described above, LGC's Board exercised its sound business judgment in selecting a reserve-setting method and a reserve level. In fact, a document submitted by the Bureau to the legislature states that an RBC of 4.2 "is not out of line with the range of RBC ratios used in other jurisdictions." Tr. 745 (App. 380); LGC Ex. 362 (Bureau's "Recommendations Concerning the Limitation of Reserves . . . of Pooled Risk Management Programs") (App. 350).

According to Jenny Emery, a national expert on risk pool practices, Tr. 2165 (App. 442), LGC ranks at the top of all the pools in terms of the engagement of its Board and the expertise of its management. Tr. 2170 (App. 443). Ms. Emery testified that the level of net assets held by HealthTrust—based on "a process that they have been through to set the target that has relied on benchmarks for other similar organizations"—is "reasonable" and "appropriate," and "a very sound policy." Tr. 2280 (App. 455). The Bureau's expert, Howard Atkinson, testified that the decisions LGC's actuary made in setting reserves were "reasonable," if "very conservative." Tr. 693. While the Presiding Officer appears to mock LGC's Chairman for considering potential events such as pandemic disease and terrorist attacks, Order at 48, the Bureau's own expert report states that "reasons why claims might exceed expected levels" include "[p]andemics" and "[a]cts of terrorism." See LGC 360, *Segal Report Regarding Pooled Risk Management Programs*, App.339 at 345.

Given that the Bureau's expert agreed that the contingencies weighed by LGC's Board were appropriate, the Presiding Officer should not have found that their consideration indicates

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<sup>11</sup> The Presiding Officer faults LGC for sometimes exceeding its target reserve level target (Order at 57), and even (inexplicably) for setting reserve level targets in the first place. See *id.* at 56-57. But to expect a risk pool to hit its RBC target with perfect accuracy is to misunderstand the nature of insurance. The Bureau's own actuary acknowledged the routine use of "target reserve levels" in the insurance industry. App. At 345.

the Board was too conservative in setting reserves.<sup>12</sup> No actuarial evidence suggested that the specific reserve level ordered by the Presiding Officer is required, either by New Hampshire law or general industry standards.<sup>13</sup> The Board's exercise of its business judgment was undertaken in good faith by directors who reasonably believed their decisions were in the best interests of LGC and its members. *See McMullin*, 765 A.2d at 917; *Unitrin*, 651 A.2d at 1373.

The Presiding Officer did not rule to the contrary, but instead simply disregarded the business judgment rule. He did not explain why LGC is not entitled to the business judgment rule's protections and ignored the statutory language expressly establishing, as a criterion for risk pool evaluation, whether the plan held "the reserves necessary to be maintained to meet expenses of all incurred and incurred but not reported claims *and other projected needs of the plan.*" *See* RSA 5-B:5, I(f) (emphasis added). The Order does not explain how the phrase "other projected needs of the plan" could be interpreted except to give substantial discretion to the Board of Directors to set reserve levels pursuant to its sound business judgment. In failing to analyze whether the Board acted within its discretion in exercising its business judgment to set LGC's reserves within this broad statutory background, the Presiding Officer committed legal error.

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<sup>12</sup> LGC's Chairman Thomas Enright offered further insight into LGC's conservative risk-management:

I've lived through two sessions where banks have failed in my life. Insurance companies have failed. Recently we've all seen auto company bailouts. ... [E]verything was fine with the New Hampshire retirement system. It was a \$4 billion program. And I woke up one morning and was told it's \$2.4 billion underfunded. ... Undercapitalization . . . is one of the biggest problems that we have in this country. And so my perspective is that this company is not going to fail on my watch. That I am going to be conservative and that I should be conservative. When the weight on my shoulders is to make sure there's a reserve level that's adequate on a horizon for 70,000 people, I am going to be conservative. I'm not going to undercapitalize this company....

Tr. 1197-1200 (App. 392-95). The Bureau offered no rebuttal to this prudent exercise of business judgment, and instead characterized it as a scheme by LGC to "amass[] enormous wealth ... ." Am. Pet. at 24 (App. 130).

<sup>13</sup> There was evidence at the hearing that insurers in other states often maintain much higher reserve ratios (6.0 to 7.0 in Massachusetts; 5.0 to 7.0 in Pennsylvania; 4.0 to 5.0 for Blue Cross/Blue Shield) than LGC's RBC target of 4.2. *See* Tr. 325, 1290 (App. 362, 411).

Rather than evaluate HealthTrust's reserves under the business judgment rule, the Presiding Officer simply declared that RSA 5-B limits reserves to "fifteen percent (15%) of claims or an RBC 3.0 as determined by the BSR, whichever is less." Order at 76, ¶9. Thus, he erred in reading requirements into the statute that are nowhere to be found in its text and contrary to the business judgment of LGC's Board of Directors.<sup>14</sup> The Order indicates that the Presiding Officer selected the 15%-of-claims method because he considers it a "straightforward method." *Id.* at 75. Straightforwardness, however, does not mean it is required by statute, that it is an appropriate or adequate method, or that a board of directors exercising its sound business judgment must adopt it, as the Presiding Officer incorrectly ruled.<sup>15</sup>

The Bureau's agreements with New Hampshire's other pooled risk management programs, PRIMEX and SchoolCare, also demonstrate that RSA 5-B does not require risk pools to use a particular method for setting reserves, or to maintain a specific reserve level. Those agreements, drafted by the Bureau and executed just weeks before the Hearing, do not subject PRIMEX or SchoolCare to the same requirements that the Presiding Officer imposed on LGC. Instead, the Bureau agreed that the PRIMEX and SchoolCare could set reserve levels, including above RBC 3.0, based on the "sound business judgment" of their directors, (LGC Ex. 334 § 3.1

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<sup>14</sup> The Presiding Officer's citation to RSA 21-I:30-b in support of his ruling that RSA 5-B requires LGC's reserves to be limited to "fifteen percent (15%) of claims or an RBC 3.0 as determined by the BSR, whichever is less," is unpersuasive. Order at 76, ¶9; *see also id.* at 29. RSA 21-I:30-b deals with a single-employer self-insurance plan operated by the State, which can draw on the general fund if reserves prove insufficient; LGC, by contrast, has no general fund to tap into if plans go awry. Additionally, RSA 21-I:30-b is inapplicable because it establishes a minimum required reserve level, not a maximum. If anything, RSA 21-I:30-b supports LGC's position that RSA 5-B does *not* mandate any particular level or method of calculating reserves, as it shows that when the legislature wishes to impose such requirements it uses express language not found in RSA 5-B. *See* RSA 21-I:30-b ("five percent of estimated annual claims and administrative costs of the health plan").

<sup>15</sup> According to the Presiding Officer, LGC's placement of certain funds in "longer term" investment vehicles "is another indication of the excess earnings and surplus available and retained by the LGC, Inc. health trust and is an improper retention that violates RSA 5-B:5, I(c)." Order at 53-54. But while it might make sense to hold *claims* reserves (held to cover known liabilities) in instruments with maturities that correspond to when the liabilities are expected to come due, *capital* reserves (held to ensure the overall financial soundness of the risk-assuming entity) need not be so invested. The Bureau's insurance industry expert conceded that at the hearing. *See* Tr. 301-303 (agreeing that capital reserves need not be invested in securities of any particular duration) (App. 357-59).

(Bureau's Risk Pool Practices Agreement with PRIMEX) (App. 258-275); BSR Ex. 65 § 3.2 (Bureau's Risk Pool Practices Agreement with SchoolCare) (App. 276-290))—which is precisely what the Order says LGC's Board cannot do. Plainly, a reserve level above RBC 3.0 based on LGC's sound business judgment is not prohibited by statute.

## **2. Return of surplus**

The Presiding Officer erred when he ordered that LGC return surplus annually in cash, instead of via rate stabilization over one or more years. Order at 77-78, ¶¶10-11. RSA 5-B:5,I(c) requires risk pools to return surplus to their members, but does not specify a required method of return. Instead, the statute requires the bylaws governing these voluntary associations to set forth “the governance of the program and other matters necessary to the program's operation.” RSA 5-B:5, I (e). LGC's bylaws describe how reserves are returned to members. *See* LGC Exs. 220 - 222. The statute further directs risk pools to consult with their members as to how surplus should be returned. *See* RSA 5-B:5 I,(g). As described on page 6 above, the clear preference of LGC's members has been for rate stabilization, not cash refunds.

The Board consulted with its outside corporate counsel and its actuary before acceding to its members' preference for rate stabilization. LGC's corporate counsel analyzed RSA 5-B and advised the Board that rate stabilization was permitted and that such a procedure was consistent with risk pool practices around the country. Tr. 1616-1620 (App. 436-40); LGC Ex. 381; Tr. 2379 (App. 471). Based on this advice and the advice of its actuary, LGC's Board adopted a policy of returning surplus via rate credits over a three-year period. The Bureau's own actuary's report supports LGC's method of returning surplus. Tr. 793 (App. 390); *see also* LGC Ex. 360 (*Segal Report* at 9 (“[p]rudent underwriting would call for trying to achieve the reduction over multiple (2-3) years during the rate revisit process.”) (App. 347).

While the Bureau may “prefer” a different method of return (*see* LGC Ex. 334 (Risk Pool Practices Agreement between the Bureau and PRIMEX states that PRIMEX will implement “the Bureau’s preferred surplus return methodology”) (App. 258-275)), LGC could not have violated RSA 5-B by failing to adhere to a “preferred” method that is not required by statute or rule.<sup>16</sup> It is instructive that the original version of Senate Bill 212-FN, which was introduced in the 2012 legislative session, recognizes the lack of specific legislative mandate and proposed the “[r]eturn [of] all earnings and surplus in excess of any amounts required for claims, reserves and the purchase of excess insurance, and the reasonable costs of administration to the state or the participating political subdivisions which contributed to the pooled risk management program, annually and in cash.” This amendment was not enacted by the Legislature. *See* RSA 5-B.

Thus, the Presiding Officer’s requirement that LGC effectuate returns annually and only in cash re-writes the statute rather than simply “fill[ing] in the details to effectuate the purpose of the statute.” *In re Wilson*, 161 N.H. at 662. For that reason, it was error as a matter of law.

### **3. Amounts “invested in capital assets”**

In ordering HealthTrust to return \$33.2 million in reserves, the Presiding Officer included \$2,237,390 “invested in capital assets.” LGC Ex. 159 (2010 HealthTrust Financial Statement, at 19 (App. 309)).<sup>17</sup> These capital assets include computer systems, furniture, and other equipment necessary to operate a risk pool. *Id.* at note 7 (App.321). The evidence at the hearing was that in evaluating reserve levels for insurance-like entities, “non-admitted” assets—assets that would

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<sup>16</sup> The Presiding Officer’s presumption that rate stabilization is prohibited is also at odds with evidence at the hearing that when RSA 5-B was enacted, the purpose of pooled risk management programs was precisely to stabilize rates over time. *See generally* LGC Ex. 324 at 4 (NH School Board’s Insurance Trust RSA 5-B annual filing - 1987-1988 financial summary (“trust fund balance to be utilized for rate stabilization.”); Tr. 542, 590; LGC Ex. 315 (SchoolCare Articles of Incorporation (“Purpose of stabilizing future benefit costs”)), p. 39.

<sup>17</sup> The \$33.2 million ordered by the Presiding Officer is calculated by subtracting 15% of claims from the total net asset amount of \$86,781,781 reported in the 2010 audited financial statement. This total net asset amount includes \$2,237,390 invested in capital assets. *See* LGC Ex. 159 (App. 309).

not be available to pay claims, such as “furniture and equipment, software development costs, most deferred income tax assets, and certain equity investments”—should not be considered. LGC Ex. 356, p. 27 (“[I]n the event of a significant call on company financial resources, the value represented by these assets may not be available or be available at a fraction of the non-admitted amount.”). The Presiding Officer never explained why capital assets necessary to operate a risk pool should be viewed as excess reserves to be returned to members. In so ruling, the Presiding Officer committed an error of law and made an unreasonable ruling.

#### 4. Purchase of reinsurance

The Presiding Officer ordered LGC to purchase reinsurance immediately. (Order at 75). RSA 5-B:3,I, however, explicitly authorizes political subdivisions to implement “insurance by self-insurance,” and “pooling of self-insurance reserves.” *Id.* This requirement also is unsupported by RSA 5-B, because reinsurance (“excess insurance”) is a cost that *may*, not must, be incurred. *See* RSA 5-B:5,I(c) (“any amounts required . . . for purchase of excess insurance”).

The evidence supported LGC’s reasonable business judgment not to purchase reinsurance. *See* Tr. 1242-43 (“We have had considerable discussion about lessening our dependence on reinsurance and taking on more of the risk ourselves. And what gives us the capability to do that is our asset base, our reserves . . . . [O]ver the long haul, that saves our members money,” as it permits LGC to “use our asset base” to cover the “reinsurance issue and still retain the value of that asset base.”) (App. 398-99); *see also* Tr. 2371 (LGC’s “reserves are sufficient . . . in the long term [to] cover . . . what we might call catastrophic or major claims”) (App. 470); Tr. 2238-43 (LGC has saved taxpayers millions of dollars by not having to purchase reinsurance) (App. 448-53); Tr. 1390-91 (not purchasing reinsurance seen as a benefit to members) (App. 413-14). The requirement that LGC purchase reinsurance is baseless and

contrary to the statute, and should be vacated. It also exceeds the remedial power of the Presiding Officer, which is limited by RSA 5-B:4-a, VII to imposing fines and ordering rescission, restitution, or disgorgement.

**5. Payment of certain administrative expenses**

According to the Presiding Officer, LGC's decision to create an employee retirement program somehow demonstrates that its reserves were excessive. Order at 43-44. But risk pools are allowed to retain "any amounts required for administration," RSA 5-B:5, I(c), with no prohibition against such conventional components of an employee compensation system as a retirement plan. Nor has the Bureau enacted any rules barring such expenditures. Moreover, the Bureau's own actuary found HealthTrust's administrative expenses—approximately 7.7 percent of claims—to be reasonable. Tr. 733-35 (App. 373-75); *see also* Tr. 735-36 (LGC's administrative expenses were over two percent below the Bureau's recommended cap of "10 percent of total claims") (App. 375-76). The Presiding Officer erred when he failed to defer to the business judgment of LGC's Board of Directors that the retirement plan was required for administration of its risk pools.

**6. Strategic support to the Workers' Compensation Trust**

Nothing in RSA 5-B supports the Presiding Officer's conclusion that HealthTrust's strategic support for the Workers' Compensation risk pool from 2000 forward was unlawful. RSA 5-B:3, I permits political subdivisions to "provide for pooling of self-insurance reserves, risks, claims and losses, and of administrative services and expenses associated with them among political subdivisions." *Id.* Nowhere in RSA 5-B is there any suggestion that a risk pool may not provide strategic support for an affiliated pool. On the contrary, the statute makes clear that a risk management program may offer and support more than one line of coverage. RSA 5-B:3,

III (“Pooled risk management programs established for the benefit of political subdivisions may provide *any or all* of the following coverages: (a) Casualty ... worker’s compensation ... property ... medical ....”) (emphasis added).

As explained above, the then-independent Boards of HealthTrust and Property-Liability Trust determined in 1999 that it would benefit their respective members to establish, and have HealthTrust strategically support, a workers’ compensation risk pool. The Boards believed that offering integrated health benefits—including workers’ compensation coverage and accompanying health management services—would reduce losses and generate long-term cost savings for each pool’s members. LGC Exs. 2-6. After the 2003 corporate reorganization, LGC’s Board of Directors continued to believe it would benefit all of LGC’s members for HealthTrust to continue to strategically support the Workers’ Compensation risk pool as part of LGC’s overall risk management plan. *See* LGC Exs. 67, 68 (2004 Long-Range Planning and Executive Session Minutes (App. 239-54)).

RSA 5-B:5 permits a risk pool’s board of directors to exercise its business judgment in deciding what steps to take to reduce long-term costs and risks. *See* RSA 293-A:8.30(a) (corporate directors must act in good faith, with the care an ordinarily prudent person would exercise under similar circumstances, and in a manner they reasonably believe is in the best interests of the corporation). LGC’s Board exercised its sound business judgment to determine that strategic support for the Workers’ Compensation Trust was in the best interests of all of its members, including members of HealthTrust. According to risk pool practices expert Jenny Emery, “those that have embraced an integrated philosophy to managing employee health would tell you that they know it has improved the health and productivity of their population and they would never go back.” Tr. 2210-11 (App. 444-45). Emery testified:

Q. Could and did the board conclude that the support and the growth and the progress in the workers' compensation program was good for all the members of LGC, whether or not they were particularly purchasing workers' comp?

A. Absolutely. They – they concluded that in part because they were told that by members who were not members of work comp. The preponderance of input from members were: “we like your products and services and we want you as an option in all of these areas.”

Tr. 2224-25 (App. 446-47); *see also id.* at 2266 (“HealthTrust . . . got stronger during the same period of time that the workers' compensation program got stronger.”) (App. 454).

When strategic support commenced in 2000, HealthTrust and Property-Liability Trust each had an independent board of directors; contrary to the Presiding Officer's characterization, this was not something that was foisted upon HealthTrust by its corporate parent. The Presiding Officer had no basis for ruling that LGC's strategic support for its Workers' Compensation risk pool was improper, and his ruling should be reversed. *See* Order at 78, ¶13.

**II. The Presiding Officer's retroactive application of RSA 5-B to transfers executed before the Bureau obtained regulatory authority in June 2010 is unconstitutional.**

As explained above, when the Presiding Officer ordered the repayment of \$17.1 million the Workers' Compensation risk pool received in strategic support from HealthTrust between 2004 and 2010, he violated LGC's right to due process and fair notice. *See* U.S. Const. amends. V and XIV; N.H. Const. part I, article 15. Because the Secretary did not obtain regulatory authority over RSA 5-B risk pools until June 14, 2010, *see* RSA 5-B:4-a, the repayment order also is an unconstitutional retroactive exercise of power by the Presiding Officer in violation of Part I, Article 23 of the New Hampshire Constitution. Thus, even if the Court affirms the return of funds after the Secretary acquired jurisdiction over risk pools, the proper amount pursuant to the Order is approximately \$2.099 million. *See* Order, p. 41, Table 3 (pro-rating \$3.875 million paid by HealthTrust in 2010 for 6.5 months Secretary had authority equals \$2.099 million).

“Retrospective laws are highly injurious, oppressive, and unjust.” N.H. Const. part I, article 23. “[E]very statute which takes away or impairs vested rights, acquired under existing laws, or creates a new obligation, imposes a new duty, or attaches a new disability, in respect to transactions or considerations already past, must be deemed retrospective.” *Norton v. Patten*, 125 N.H. 413, 415 (1984) (quotation marks omitted). “Where a law affects substantive rights and liabilities, it is presumed to apply only to future causes of action unless there is some evidence of legislative intent that the statute be applied retrospectively.” *Id.* at 417; *see also State v. Johnson*, 134 N.H. 570, 572-73 (1991) (“The general rule that statutes are only to be applied prospectively is further buttressed by a presumption against retrospective application when the statute affects a party’s substantive rights.”)<sup>18</sup> A statute affects substantive rights when it “enlarge[s] or diminish[es] the parties’ rights and obligations.” *Workplace Systems, Inc. v. Cigna*, 143 N.H. 322, 324 (1999). Thus, an amendment shifting the burden of proving insurance coverage from insured to insurer was held to be substantive because it “fundamentally changed the relationship between the parties . . . in a fashion that significantly bears on the ultimate relationship of their rights.” *Id.* at 325-26 (quotation marks omitted).

Until 2009, RSA 5-B:4 expressly provided that “[n]othing contained in this chapter shall be construed as enabling the department to exercise any rulemaking, regulatory or enforcement authority over any pooled risk management program formed or affirmed in accordance with this chapter.” On June 14, 2010, RSA 5-B was amended to give the Secretary “the power to investigate pooled risk management programs, issue cease and desist orders, initiate adjudicatory proceedings, impose administrative fines, and order rescission, restitution, or disgorgement.”

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<sup>18</sup> By contrast, statutes have been found to apply retrospectively where they do not affect substantive rights, but are procedural or remedial in nature. *See In re G.*, 120 N.H. 153, 155 (1980) (probate court’s power to order psychiatric evaluations); *Gelinas v. Mackey*, 123 N.H. 690, 695 (1983)(calculation of interest on judgments).

The Order creates new obligations and duties regarding RSA 5-B, because LGC has been ordered to undo transfers between its risk pools that were executed before the Bureau had any power to regulate them. The Order also affects substantive rights and liabilities, as it voids the transfer of millions of dollars between LGC's risk pools that were lawful and proper when executed. The requirement plainly "enlarge[s] or diminish[es] the . . . rights and obligations" of affected risk pools. *Workplace Systems*, 143 N.H. at 324. The Bureau recognized that it may lack the power to vitiate transactions executed before it had regulatory authority by stating the following in its Memorandum on Questions Presented by the Court Regarding Remand filed with this Court (page 2, footnote 3):

There may also remain a legal question as to whether the Presiding Officer can consider [in calculating amounts of surplus to be returned] member contributions made prior to June 14, 2010 when the Bureau was given statutory powers to investigate and regulate 5-B pools. R.S.A. 5-B:4-a.

As explained above, all of the returns in the Order should be vacated. Because the order of the repayment of \$17.1 million the Workers' Compensation risk pool received in strategic support from HealthTrust was an unconstitutional retrospective application of a new restriction in RSA 5-B, even if the Court affirms the return of funds after the Secretary acquired jurisdiction over risk pools, the proper amount pursuant to the Order is approximately \$2.099 million.

**III. The Presiding Officer denied LGC due process by failing to disqualify himself based on his pecuniary interest in the duration and outcome of the proceeding.**

No right is more sacred than the right to due process of law when charged by the sovereign with unlawful conduct. U.S. Const. amend. XIV (A state shall not "deprive any person of life, liberty, or property, without due process of law."); N.H. Const. part I, article 35 ("It is essential to the preservation of the rights of every individual, his life, liberty, property, and character, that there be an impartial interpretation of the laws, and administration of justice.").

“A fair trial in a fair tribunal is a basic requirement of due process.” *In re Murchison*, 349 U.S. 133, 136 (1955). Because the Presiding Officer’s arrangement with the Secretary gave him a direct and indirect pecuniary interest in the duration and outcome of the proceeding, his decision not to disqualify himself was erroneous and an unsustainable exercise of his discretion.

A judicial officer may not have a pecuniary interest in the outcome of the matter being tried. *See Appeal of Grimm*, 141 N.H. 719, 721 (1997); N.H. Const. part I, article 35 (“It is the right of every citizen to be tried by judges as impartial as the lot of humanity will admit.”). The right to an impartial decision-maker extends to administrative proceedings. *See Gibson v. Berryhill*, 411 U.S. 564, 578-79 (1973); *In re Town of Bethlehem*, 154 N.H. 314, 330 (2006). “A *per se* rule of disqualification due to the probability of unfairness, applies when the trier has pecuniary interests in the outcome.” *Grimm*, 141 N.H. at 721 (quoting *Plaistow Bank & Trust Co. v. Webster*, 121 N.H. 751, 754 (1981)); *see also Haas v. County of San Bernardino*, 45 P.3d 280, 286 (2002). An arrangement need not directly tie the adjudicator’s compensation to the outcome of a case to offend due process; both direct and indirect pecuniary interests are impermissible. *See Ward v. Village of Monroeville, Ohio*, 409 U.S. 57, 60-61 (1972) (revenue to village derived from fines and fees for convictions in mayor’s court held to violate due process); *Tumey v. Ohio*, 273 U.S. 510, 532-34 (1927).

Because “our system of law has always endeavored to prevent even the probability of unfairness,” *In re Murchison*, 349 U.S. at 136, “[e]very procedure which would offer a possible temptation to the average man as judge . . . not to hold the balance nice, clear, and true between the State and the accused denies the latter due process of law.” *Id.* (quoting *Tumey*, 273 U.S. at 532). It is immaterial that the pecuniary interest may be *de minimis*, *see Connally v. Georgia*, 429 U.S. 245, 250-51 (1977) (justice of peace paid \$5.00 if search warrant issued and not paid if

warrant application declined), because the test is one of “possible temptation,” where the mere appearance of bias violates due process, *see Aetna Life Ins. Co. v. Lavoie*, 475 U.S. 813, 821-25 (1986) (judge ruled in case involving similar issue to that present in judge’s own pending action).

The test does not require proof of actual bias; a system that creates improper financial incentives violates due process. In *Lucky Dogs LLC v. City of Santa Rosa*, the Court held that a system allowing the hearing officer to impose fees upon the losing party, and resting the hearing officer’s prospects for future employment “solely on the City’s good will,” was unconstitutional. 913 F. Supp. 2d 853, 860 (N.D. Cal. 2012). The Court observed that a hearing officer who is not a permanent City employee “has financial incentive to rule in the City’s favor, because [she] presumably would like the City to hire her again, and she might reasonably believe that it is more likely to do so if she rules in its favor.” *Id.*; *see also Haas*, 45 P.3d at 285 (“a temporary administrative hearing officer has a pecuniary interest requiring disqualification when the government unilaterally selects and pays the officer on an ad hoc basis and the officer’s income from future adjudicative work depends entirely on the government’s goodwill.”). Likewise here, the Presiding Officer’s temporary status and fee-shifting power created an impermissible incentive to rule in the Secretary’s favor, thereby awarding the Bureau its costs and fees. *See Lucky Dogs*, 913 F.Supp. 2d at 860 (fee-shifting power “creates an additional incentive for the hearing officer to try to ingratiate herself with the [regulator]; ruling for the [regulator] then would not only entitle the [regulator] to the tax award/penalties sought, but would spare the [regulator] the cost of the hearing officer.”)

The Presiding Officer’s pecuniary interest was not limited to the possibility of future employment. As detailed above, LGC was incorrectly informed that the Presiding Officer’s agreement with the Secretary was a flat fee contract, Tr. 2306, 2311, 2313 (App. 457, 458, 459),

when the contract provided that he would be paid bi-weekly for the duration of the proceedings (up to a “not to exceed” amount). Thus, if the Presiding Officer had granted LGC’s motions to dismiss instead of letting the case proceed to hearing, he would have reduced the duration of the matter, thereby reducing his own compensation by tens of thousands of dollars. Likewise, if the Presiding Office had granted LGC’s motion for his disqualification at the hearing, he would have foregone the compensation he later received for drafting his 80-page Order and his other post-hearing work. This direct financial stake in the duration of the proceeding further exacerbated the due process problem created by his temporary status and fee-shifting power.

Importantly, the Presiding Officer twice renegotiated his contract with the Secretary while the matter was pending, including once *during the hearing*, with no notice to LGC. The potential temptation and the appearance of unfairness are plain when the Presiding Officer simultaneously conducted a hearing to which the Bureau was a party while negotiating with the Secretary over how much he would be paid for conducting the hearing. In fact, the “probability of unfairness” was overwhelming. *See Appeal of Grimm*, 141 N.H. at 721 (“A *per se* rule of disqualification due to the probability of unfairness, applies when the trier has pecuniary interests in the outcome.”) (quoting *Plaistow Bank & Trust Co.*, 121 N.H. at 754).

In sum, the Presiding Officer was unilaterally selected and paid by the Secretary in a proceeding where he would award fees if the Bureau prevailed (and in fact awarded fees even where the Bureau did not prevail); was paid based on the duration of the proceeding; was paid more for having denied LGC’s dispositive motions than he would have been paid for granting them; and twice renegotiated his contract with the Secretary to increase his pay while the case was pending. These procedures are inconsistent with the “right of [LGC] to be tried by judges as impartial as the lot of humanity will admit.” (N.H. Const. part I, article 35.) Each of these flaws

in the process “offer[ed] a possible temptation to the average man as judge . . . not to hold the balance nice, clear, and true between the State and the accused . . . .” *In re Murchison*, 349 U.S. at 136 (quoting *Tumey*, 273 U.S. at 532). Taken as a whole, the “probability of unfairness” (*Grimm*, 141 N.H. at 721) is inescapable. Simply put, this was not the process LGC was due. See U.S. Const. amend. XIV; N.H. Const. part I, article 35.

**IV. The Presiding Officer erred in awarding the Secretary costs and attorneys’ fees for counts on which LGC prevailed.**

RSA 5-B:4-a, V provides for the Bureau to recover costs and fees “upon the secretary of state’s prevailing at hearing . . . .” The Presiding Officer ordered LGC to pay all of the Bureau’s costs and attorneys’ fees in connection with the case. The Amended Petition included six counts. One count (count VI, alleging civil conspiracy) was dismissed before the Hearing. LGC prevailed on three of the five remaining counts (counts III, IV & V, alleging securities-law violations) and the individual respondents prevailed on all counts against them. Given that LGC and the individual respondents prevailed on a number of counts, the Presiding Officer lacked a basis for requiring it to pay all of the Bureau’s costs and attorneys’ fees. At most, LGC should be required to pay costs and fees incurred in connection with the two counts on which the Bureau prevailed, particularly because the RSA 5-B counts are easily distinguished from the securities counts. See *Van Der Stok v. Van Voorhees*, 151 N.H. 679, 685 (2005) (“Where a party prevails on some claims and not others, and the successful and unsuccessful claims are analytically severable, any fee award should be reduced to exclude time spent on unsuccessful claims.”) (quotation marks omitted).

CONCLUSION

For the foregoing reasons, the Final Order should be vacated.

Appellant requests fifteen minutes of oral argument.

The decision from which LGC appeals is in writing, and appended to this brief. *Rules of the Supreme Court, Rule 16(3)(i)*.

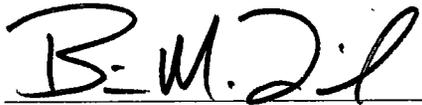
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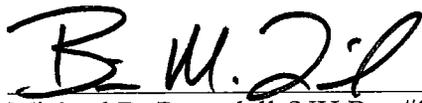
LOCAL GOVERNMENT CENTER, INC., *et al*  
By Their Attorneys,

PRETI FLAHERTY, PLLP

Dated: August 12, 2013

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**CERTIFICATE OF SERVICE**

I certify that on the 12th day of August, 2013, I mailed two copies of the foregoing *Appellants' Brief*, via first class, postage prepaid, to all counsel of record.

  
for William C. Saturley

STATE OF NEW HAMPSHIRE

DEPARTMENT OF STATE

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IN THE MATTER OF: )  
)  
)  
Local Government Center, Inc.; )  
Local Government Center Real Estate, Inc.; )  
Local Government Center Health Trust, LLC; )  
Local Government Center Property-Liability Trust, )  
LLC; )  
Health Trust, Inc.; )  
New Hampshire Municipal Association Property-Liability ) Case No.: 2011000036  
Trust, Inc.: )  
LGC – HT, LLC )  
Local Government Center Workers’ Compensation )  
Trust, LLC; )  
And the following individuals: )  
Maura Carroll; Keith R. Burke; Stephen A. Moltenbrey; )  
Paul G. Beecher; Robert A. Berry; Roderick MacDonald; )  
Peter J. Curro; April D. Whittaker; Timothy J. Ruehr; )  
Julia A. Griffin; Paula Adriance; John P. Bohenko; and )  
John Andrews )  
)  
RESPONDENTS )  
)

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**FINAL ORDER**

PROCEDURAL BACKGROUND

The underlying matter arises from a staff petition, as amended, submitted by the Bureau of Securities Regulation (“BSR”) alleging that the named respondents undertook a series of acts and omissions resulting in violations of New Hampshire law, namely RSA 5-B, entitled “Pooled Risk Management Programs” and RSA 421-B, entitled “Securities.” Pursuant to RSA 421-B:26-a, V a

“Notice of Order” issued on September 2, 2011 by the secretary of state granting the BSR petition. The petition was timely amended and presented in more detail. The actions alleged in the BSR petition generally relate to the formation, organization and operation of several related entities, referenced generally as the Local Government Center, Inc. (“LGC”) and certain of its affiliated and LGC controlled organizations, and originally of two individuals who have held the position of executive director of the LGC, and several of its board members in connection with the structure and operation of pooled risk management programs. The actions alleged in the BSR petition also relate to the legality of certain expenditures by LGC and its affiliates, particularly funds contributed by municipalities and employees of municipalities to obtain risk management services and insurance coverage. Among these health services and products were medical and dental insurance coverage plans provided through agreements between the LGC and those public employers or “political subdivisions” as referred to in RSA 5-B:2, III.

On November 3, 2011 an order issued denying intervenor status to several public employee unions that wished to participate as parties in this administrative proceeding.<sup>1</sup> On March 30, 2012 an order issued granting the BSR motion withdrawing Count VI of its amended petition that alleged the respondents’ actions constituted a civil conspiracy. At the time of the hearing several orders had issued granting motions of the Bureau of Securities Regulation (“BSR”) requesting a voluntary non-suit and consequent withdrawal of complaints against all individuals originally named as respondents except: the present executive director, Maura Carroll; and Peter Curro, a long-time member of the board of directors.

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<sup>1</sup> Professional Firefighters of New Hampshire, New England Police Benevolent Association, Service Employees International Union – SEA, Council 1984; National Education Association – NH; American Federation of Teachers-NH; American Federation of State County and Municipal Employees, Council 93

Over the period of time following the notice of hearing on September 2, 2011 through the beginning of the evidentiary hearing, the presiding officer was required by the actions of the parties' counsel to issue some fifty (50) prehearing and preliminary orders addressing: scheduling differences; addressing evidence discovery disputes; prohibiting attempt by other parties to intervene in the proceedings; prohibiting testimony by certain opposing witnesses; limiting testimony of certain opposing witnesses; issuing subpoena orders to witnesses and denying other subpoena orders sought; clarifying previous orders, allowing out of state counsel to join in the representation of parties and participate at hearing; considering dispositive motions at four stages in the proceeding; and resolving conflicting production ideas related to live video-streaming of the evidentiary hearing.<sup>2</sup>

The final evidentiary hearing was conducted on sequential days from April 30, 2012 through May 11, 2012, excluding the intervening weekend in Concord, New Hampshire, with all parties represented by legal counsel. That hearing resulted in over 2,437 pages of transcribed dialogue and the submission of approximately 8,000 pages of exhibit documents. The respondents, by previous agreement among themselves, elected to integrate the presentation of their individual cases in chief. As the BSR presented its case, each of the respondents were given the opportunity to cross examine witnesses and to challenge the admission of exhibits offered by the BSR. Upon the completion of the BSR's case, the respondents proceeded with their integrated approach in offering their own witnesses, eliciting testimony of witnesses called by other respondents and offering exhibits for admittance. Each party was given the opportunity to present an oral opening and throughout the conduct of the hearing to present evidence, witnesses and conduct cross-examination. Oral motions and objections occurred

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<sup>2</sup> An index and copy of all filings and orders appears at this link: <http://www.sos.nh.gov/locgovctr/index.html>

during the course of the hearing that the hearing officer considered and made oral rulings as appropriate to administrative evidentiary hearings.

By prior arrangement post-hearing legal memoranda were permitted in place of oral closings. However, respondents did undertake oral argument on dispositive motions. These oral arguments were essentially similar to prior dispositive motions and served a purpose similar to a closing argument. The BSR also argued its objections to the motions being made at the end of the hearing. Rulings on those dispositive motions were taken under advisement and are incorporated into this instant decision. Submission of enumerated statements of fact and findings of law were expressly not requested by the hearing officer. At the request of counsel for LGC on the next to last day of evidence and with the assent of all other counsel, the previously agreed dates for submission of legal memoranda and submission of response briefs were extended to June 4, 2012 and June 7, 2012, respectively. Upon timely receipt of those memoranda, the record was thereafter closed. All appropriate prior findings and determinations made in previous orders are incorporated into the findings and determinations appearing within this order as appropriate. After reviewing the evidence presented, considering the credibility of each witness and qualifications of those offered as expert witnesses, assigning appropriate weight to the evidence submitted, and considering the legal arguments made by each party's counsel I find the facts appearing in the following discussion to be true and legally sufficient to support the decision and accompanying order.

#### JURISDICTION

The secretary of state is responsible for and is granted the authority to conduct adjudicatory proceedings and hearings related to violations of RSA 5-B (the "Pooled Risk Management Programs")

law) and RSA 421-B (the “Securities” law). The secretary of state may delegate this responsibility to a presiding officer, and the authority and jurisdiction to conduct such proceedings is exclusive. (See RSA 5-B:4-a, I and RSA 421-B:26-a, I). The presiding officer has the authority to regulate and control the course of the administrative proceedings and dispose of procedural requests. (RSA 421-B:26-a, XIV). The presiding officer may rule upon a motion when made or may defer decision until a later time in the hearing, or until after the conclusion of the hearing. (RSA 421-B:26-a, XIX). The provisions of RSA 541-A do not apply to these proceedings. (RSA 421-B:26-a, I). Following the hearing, the presiding officer may order penalties and fines as relief including rescission, restitution or disgorgement. (RSA 5-B:4-a, VII).

#### SUMMARY

This matter arises from allegations in a petition brought by the Bureau of Securities against the several institutional respondents, collectively referred to as “LGC, Inc. and its entities” and two remaining individual respondents<sup>3</sup> pursuant to RSA 421-B:26-a. The BSR alleges that actions undertaken by the respondents violate provisions of RSA 5-B, the “Pooled Risk Management Program Statute” related to: (1) the organizations that were formed to operate each pooled risk management program and the governance over each pooled risk management program; and (2) the operation of the pooled risk management programs by the respondents in a manner that allowed unpermitted expenditures of pooled risk management program funds by the LGC, Inc. that has resulted in an excess accumulation of funds and a failure to return all appropriate funds to the political subdivisions which were members of the health pooled risk management program and the property liability pooled risk

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<sup>3</sup> At the outset of the proceedings there were eleven additional individuals named as respondents who, over the course of the proceedings, were released after entering settlement agreements with the BSR (9), or by reason of severe ill health (1), and death (1), and complaints against them were withdrawn prior to this decision.

management program. Based upon the evidence and applicable law the respondents collectively referred to as the “LGC and its entities” have violated the provisions of this statute which was enacted especially for the benefit of the state’s political subdivisions.

The organizational violations of RSA 5-B:5, I (b) and (e) result from its failure to meet and maintain standards required by this statute to operate each pooled risk management program at all times consistent with a governing board and governing by-laws of a legal entity organized under New Hampshire law. These violations result from structuring the institutional relationship among the LGC and its several entities in a manner that establishes a hierarchy of interests which serves to diminish the priority interest and benefits each pooled risk management program was intended, by the statute, to receive through its own governance. The organizational relationship also results in a conglomerate imbued with conflicts of interest adverse to the required standards for operation of each pooled risk management program.

These operational violations of RSA 5-B:5, I (c) result from the actions and practices of the LGC, Inc. and its entities that improperly accrued and retained unnecessary surplus funds, improperly transferred assets and improperly expended funds for purposes beyond those permitted in the statute, and failure to return excess funds to political subdivisions which are members of each individual pooled risk management program. There is insufficient evidence to establish that the personal conduct of the individuals named as respondents, Maura Carroll and Peter Curro, can be found to violate the provisions of RSA 5-B and all violations of RSA 5-B alleged against these two individuals are dismissed.

The BSR also alleges that actions undertaken by the respondents violate certain provisions of RSA 421-B, the “Securities Act,” related to two forms of securities: (1) pooled risk management

program agreements with political subdivision members; and (2) New Hampshire Municipal Association, LLC membership agreements. These violations concern various aspects of issuing, reporting, offering, marketing, brokering and selling these agreements by the several institutional and individual respondents. Based upon the evidence and the applicable law neither of these agreements are found to constitute securities. The NHMA LLC membership agreements are not deemed securities because there was insufficient evidence produced to establish the existence of any written agreement beyond an annual request that a member's dues be paid and that payment of those dues were required to participate in the pooled risk membership programs. The pooled risk management program agreements are not deemed securities as they lack a legally sufficient "expectation of profit" that the law requires of securities. Since all the violations of the securities law alleged depend upon the underlying determination that the agreements are securities, all violations of RSA 421-B alleged against all respondents are dismissed.

## DECISION

### *Pooled risk management programs*

The so-called "Pooled Risk Management Program Statute," RSA 5-B, which is central to consideration of the BSR's allegations against the respondents became effective on July 24, 1987. Prior to that time while there were statutes relating to for-profit insurance providers there was some question as to whether the so-called "pooled risk management programs" at issue in these proceedings were subject to the requirements of the existing insurance statute or subject to taxation. At that time what was known as the New Hampshire Municipal Association, Inc. (NHMA, Inc.) was a not-for-profit New

Hampshire corporation that provided lobbying and legislative services for its members as well as legal counsel and training events. It also provided administrative support to certain affiliate associations comprised of municipal managers, department heads and other local government administrators.

The violations of the statutory provisions RSA 5-B:5, I (b) and (e) to follow are approached through an examination and determination of the manner by which the several not-for-profit organizations were legally structured and organized, and of the manner by which their organizational relationships deviated from the standards of governance expressed in those provisions of the statute.

By 1987, the NHMA, Inc. had created a New Hampshire not-for-profit corporation to provide pooled health insurance coverage for member political subdivisions, the NHMA Health Insurance Trust, Inc. incorporated on February 11, 1985. It also had created a separate New Hampshire not-for-profit corporation, the NHMA Property Liability Trust, Inc. incorporated on June 3, 1986. Each was characterized as an "affiliate" of the NHMA, Inc. by its then executive director, John Andrews. Andrews also became executive director of the later created LGC, Inc. and was assigned responsibility for the operation of all entities of what was to become a conglomerate enterprise under the sole governance of LGC, Inc.

At the time RSA 5-B became law in 1987, the NHMA Health Trust, Inc. (also referred to broadly as the "health trust") and the NHMA Property Liability Trust, Inc., (also referred to broadly as the "property liability trust") each was governed under its own corporate by-laws by its own separate board of trustees that was responsible for policy and for expending its own pooled risk management program's funds. Such pooled risk management programs offer an alternative to traditional, single employer, insurance programs. Each of these corporations operated a pooled risk management program through

which political subdivisions *e.g.* municipalities, counties, school districts, could combine or “pool” as one customer and obtain insurance coverage and risk management in return for the payment of an assigned premium rate to either the NHMA Health Trust, Inc. or to the NHMA Property Liability Trust, Inc. or to both if seeking both types of insurance coverage.

Until passage of RSA 5-B there was no specific law addressing these pooled risk management programs operated by not-for-profit organizations.<sup>4</sup> Upon its passage, all pooled risk management programs became subject to its standards and requirements. Because each program was designated as a not-for-profit New Hampshire corporation, each of these entities submitted certain annual informational filings with the office of the secretary of state. However, until RSA 5-B was amended in 2010<sup>5</sup> there was no requirement or authority within the divisions of the office of the secretary of state, now known as the department of state, to review the programmatic operation, program performance or to investigate these pooled risk management programs. These programs operated within their separate corporations until a complete reorganization was undertaken by LGC, Inc in 2003 when the assets of each of the pooled risk management programs were taken under direct control of the board and staff of the LGC, Inc. At that time, there was also no requirement that the office of the secretary of state review and validate filings of federal Internal Revenue Service, IRC section 115 government income exclusion forms filed with it, beyond determining if the corporation was filing as a not-for-profit corporation. The NHMA, Inc., in the person of its executive director, John Andrews, who was an attorney, wrote the

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<sup>4</sup> Also at that time there were two other insurance pooled risk management programs serving local government entities within the state that were not affiliated with NHMA, Inc.

<sup>5</sup> RSA 5-B:4-a

proposed legislation that was submitted to the legislature through the sponsorship of at least one of its board members, Representative Robert Wheeler, and that effort eventually became RSA 5-B in 1987.

In this statute the legislature expressed the purpose of “pooled risk management programs” by stating “that pooled risk management is an essential governmental function by providing focused public sector loss prevention programs, accrual of interest and dividend earnings which may be returned to the public benefit...” and by providing further that the “pooled risk management programs that meet the standards established by this chapter not be subject to insurance regulation and taxation by the state.” RSA 5-B:1. The statute allows that the pooled risk management program agreements may, “provide for pooling of self-insurance reserves, risks, claims and losses, and of administrative services and expenses associated with them among political subdivisions.” RSA 5-B:3, I. Political subdivisions are defined in the statute as, “any city, town, county, school district, chartered public school, village district, school administrative unit, or any district or entity created for a special purpose administered or funded by any of the above-named governmental units.” RSA 5-B:2, III.

There are standards established by the statute relevant to the matters at issue in these proceedings. Three of these standards focus on the pooled risk management program’s organization and governance and provide that it, (1) be a legal entity organized under New Hampshire law;<sup>6</sup> (2) be governed by a board;<sup>7</sup> and, (3) be governed by written bylaws.<sup>8</sup> The allegations that these three statutory requirements were violated generally form the basis of Count I of the BSR’s petition.

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<sup>6</sup> RSA 5-B:5, I(a)

<sup>7</sup> RSA 5-B:5, I(b)

<sup>8</sup> RSA 5-B:5, I (e)

Several other standards pertain to the operation of the pooled risk management programs by the respondents and generally form the basis of Count II of the BSR's petition. These operational standards provide that a pooled risk management program, (1) return all excess earnings and surplus to the participating political subdivisions;<sup>9</sup> (2) provide an annual audit of financial transactions by an independent certified public accountant to the department of state and to [pooled risk management program] participants;<sup>10</sup> and, (3) provide an annual actuarial evaluation of the pooled risk management program to the department of state and to its participants.<sup>11</sup>

### *Structure and Governance*

This portion of the decision calls for the interpretation and application of three provisions of RSA 5-B. These provisions require that "each program" be a legal entity organized under New Hampshire law pursuant to RSA 5-B:5, I (a). Each program also must be governed by a board pursuant to RSA 5-B:5, I (b); and be governed by written by-laws RSA 5-B:5, I (e). The LGC, Inc., the successor to NHMA, Inc.<sup>12</sup>, was also a New Hampshire corporation that was governed by a separate board and written by-laws. At the time of the legislature's consideration of the provisions of RSA 5-B in 1987, each pooled program and the NHMA, Inc. was a New Hampshire legal entity, *i.e.* not-for-profit corporations, each governed by a board and governed by written bylaws. Three legal entities, three separate governing boards, three sets of written by-laws.

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<sup>9</sup> RSA 5-B:5, I (c)

<sup>10</sup> RSA 5-B:5, I (d)

<sup>11</sup> RSA 5-B:5, I (f)

<sup>12</sup> In 2003 the New Hampshire Municipal Association, Inc. changed its name to the Local Government Center, Inc. after the Local Government Center, Inc. had changed its name to the Local Government Center Real Estate, Inc.

NHMA, Inc. created the New Hampshire Health Insurance Trust, Inc., also a New Hampshire not-for-profit corporation on February 13, 1985 and later on June 3, 1986 it created the New Hampshire Property Liability Trust, Inc., another New Hampshire not-for-profit corporation. After each entity's creation, the so-called "health trust" and "property liability trust" operated what would later be characterized in 1987 by RSA 5-B as a "pooled risk management program." Each of these programs was housed in a separate corporation with a governing board comprised of directors or trustees, separate from the other and separate from NHMA, Inc. Each of these corporations operated a separate insurance program and served memberships that were not identical. With the passage of RSA 5-B both the health trust and the property liability trust became subject to its provisions through the affirmation clause of that statute.<sup>13</sup>

Thereafter NHMA, Inc. embarked upon a series of actions that are alleged by the BSR to have resulted in the violation of certain requirements of that statute. The evidence reveals a complex, if not convoluted, history of changes and attempted changes to the organizational structure and governance of the pooled risk management program corporations by what is now known as the LGC, Inc. and its related entities (See Joint Exhibit #2 for timeline depicting certain organizational actions for the period 2002-2010 attached to this decision). The LGC, Inc. and its related entities now, and since 2003, may essentially be viewed as a business conglomerate. As of December 31, 2010, the last date for which financial statements were provided as evidence at hearing, it consisted of eight related entities: Local Government Center, Inc.; Local Government Center HealthTrust, LLC; the original Health Trust, Inc. (dissolved during a period of 2006-2011); Local Government Center Property-Liability Trust, LLC; the original New Hampshire Municipal Association Property Liability Trust, Inc. (dissolved during a period

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<sup>13</sup> RSA 5-B:1

of 2006-2011); Local Government Center Workers Compensation Trust LLC, merged into the Local Government Center Property Liability Trust, LLC in 2007; Local Government Center Real Estate, Inc.; and the New Hampshire Municipal Association, LLC.

In 2003 the LGC, Inc. attempted to implement a reorganization of all its related entities. It first authorized the creation of several limited liability companies in New Hampshire three of which are central here, namely LGC HealthTrust LLC, LGC Property-Liability Trust LLC, and LGC's Workers' Compensation Trust LLC.<sup>14</sup> It created first, the two New Hampshire limited liability companies because it planned the merger into each with the two corresponding pooled risk management program entities operated by the Health Trust, Inc. and New Hampshire Municipal Association Property Liability Trust, Inc., both of which were not-for-profit New Hampshire corporations. The LGC, Inc. lawyers were informed by the staff of the attorney general that neither the health trust corporation nor the property liability corporation could be merged with a New Hampshire limited liability company. The staff of the secretary of state likewise informed them that its office would not accept the registration filings to give legal standing to such a merger. The LGC, Inc.'s lawyers then embarked upon another strategy employing the creation of parallel limited liability companies in the state of Delaware into which they sought to merge the New Hampshire not-for profit health trust corporation and the property liability corporation. This strategy failed because of execution mistakes in merging the newly created New Hampshire LLC's with the newly created Delaware LLC's and then merging the two original trust corporations into the Delaware LLC's. This series of mergers was equally improper and was pointed out by the BSR 2011 investigative report as a result of its examination of LGC, Inc activities and eventually

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<sup>14</sup>After passage of RSA 5-B in 1987 a fledgling Workers Compensation pool was established by LGC Inc. to be "housed" in NHMA Property-Liability Trust, Inc. Later, on May 31, 2007 the LGC, Inc. placed the then separate LGC Workers' Compensation Trust, LLC within LGC Property-Liability Trust, LLC.

confirmed to LGC, Inc. in 2011. The rather simple result of all of this effort by LGC, Inc. to gain complete control over the Health Trust, Inc. and New Hampshire Municipal Association Property Liability Trust, Inc. failed because as its own witness, Attorney Samuels, testified, “you cannot merge an RSA 292 [non-profit] corporation into an LLC, whether it’s a Delaware LLC or a New Hampshire LLC.” Since the merger failed, each pooled risk management program continued to be legally tethered to their respective New Hampshire corporations not to a Delaware LLC, nor to a New Hampshire LLC.

The failure of the 2003 LGC, Inc. reorganization resulted in severing each of the two viable pooled risk management program’s assets and governance from its legislatively affirmed legal entity. These original corporations, that were synonymous with the health trust and the property liability trust at the time RSA 5-B became effective and continuing until 2003, were left without their assets, without their staff, and without their surplus funds. An argument can be made but was not developed at hearing by the BSR that these, what were to become “ghost” corporations, remained the legal owner of their respective assets.

After 2003 each did not file required annual documents with the office of the secretary of state and each of these corporations was administratively dissolved by the office of the secretary of state on March 1, 2006. No credible argument can be made for purposes of RSA 5-B that either Health Trust, Inc. or New Hampshire Municipal Association Property Liability Trust, Inc. functioned as legal entities between 2006 and 2011<sup>15</sup>. Revival of corporate existence for purposes of RSA 292, the not-for-profit corporation statute, may not *per se* free a legal entity from any distinct obligations, requirements or

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<sup>15</sup> On August 31, 2011 the office of the secretary of state issued a certificate of good standing for each of these corporations upon receipt of filings made by LGC, Inc. to revive them. It was not until after the BSR petition initiating these proceedings was filed against the LGC, Inc. and its entities that other documents were executed solely by Maura Carroll directed to “ratify” actions undertaken eight years previously.

standards established under other New Hampshire statutes such as RSA 5-B to maintain its status as a legal entity without interruption or cessation without consequences. See RSA 292:30, IX.

Undeterred, LGC, Inc. and its entities, decided that they were going to operate in a manner that would allow the LGC, Inc. board of directors to have complete control and dominion, by fiat, over what had been separately governed RSA 5-B pooled risk management programs. It would act as though it had reorganized itself properly. Unable to legally merge each corporation with a corresponding limited liability company the LGC, Inc. simply arranged to eliminate the board that had been separately governing each pooled risk management program, transfer the assets of each, and absorb the employees of each into a corresponding limited liability company with which it could not have legally merged.

The single board of directors of an alleged RSA 292 not-for-profit corporation thereafter would be charged with simultaneously fulfilling the varying attendant obligations due to the participating members of the health trust and property liability trust as a qualifying RSA 5-B governing board, with those participants of a separately created workers compensation trust;<sup>16</sup> participating owners of real estate interests; and participating members with legislative or lobbying interests. This “parent/subsidiary” approach employed by the LGC, Inc. and its entities in the world of public entity not-for-profit operation appears, from the weight of the testimony of all witnesses who addressed the topic, unique.

As stated above, unable to legally merge the non-profit corporations into either their respective corresponding New Hampshire or Delaware LLC’s, in on or about July 1, 2003 the LGC and its entities

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<sup>16</sup> A separate limited liability company made a part of the property liability trust by action of the LGC, Inc. in 2007 to increase its financial balance and improve its position relative to regulatory oversight of the New Hampshire department of labor.

undertook a critical action pertaining to the health and property liability trusts. The LGC, Inc. transferred each of the pooled risk management program's assets from the existing corporations' control to that of the LGC, Inc. board and by-laws simply by "changing the names on accounts and changing the employer ID numbers on the accounts," according to the LGC, Inc.'s own witnesses, Samuels and corroborated by deputy director and chief financial officer, Sandal Keffe. According to the LGC, Inc. the audited year-end financial statement for 2002 of the total assets of the health trust corporation were reported as \$49,189,000.00. The approximate total assets for the property liability trust were reported as \$32,706,000.00. The pooled risk management program assets of each, that had received specific attention in RSA 5-B, were separated from their respective governing boards and governing bylaws since they legally remained the assets of the original not-for-profit corporations, Health Trust, Inc. and New Hampshire Municipal Association Property Liability Trust, Inc. Although this transfer or taking occurred on or about July 1, 2003, other than a general resolution authorizing actions that were to be undertaken, no legal documents executed or filed at that time were presented at hearing to demonstrate that the transfers of funds or of any assets were properly, completely and timely done. Eight years later the LGC retained an attorney to address issues raised by the BSR investigative report regarding the status of these two corporations after 2003 and their administrative dissolution in 2006 by the office of the secretary of state for failure to comply with the filing requirements of RSA 292. In addition, it is noted that although the limited liability companies created by LGC, Inc., to operate the RSA 5-B pooled risk management programs filed certain documents with the office of the secretary of state from 2003 through 2011 reporting financial and organizational structure information pertaining to assets, and transactions related to those assets, that office had no authority until 2010 to investigate or initiate

administrative action for any violations of RSA 5-B that may have been revealed by those informational filings.

A specific requirement of RSA 5-B provides that a pooled risk management program be “governed by a board the majority of which is composed of elected or appointed public officials, officers, or employees.” RSA 5-B:5, I (b). The BSR advances the position that the reasonable inference to be taken from the statute in its full context is that each of the pooled risk management programs at issue in these proceedings, providing insurance coverage and risk management services to political subdivisions, is required to be governed by a board that is independent of the obligations, interests and duties of another existing board. The respondents advance a position that the statutory requirement in RSA 5-B:5, I (b) only requires governance by “a board” without any further qualification, *e.g.* the BSR term “independent,” other than the companion requirement regarding the board’s membership composition, the latter of which is not in dispute between the parties. To accurately interpret and apply a statute to a set of facts in an administrative hearing the hearing officer must apply generally accepted rules of construction recognized by our court. The court has concisely expressed several relevant rules of statutory construction that provide guidance in determining how any statute, including RSA 5-B, is to be interpreted. The court stated,

We first look to the language of the statute itself, and, if possible, construe that language according to its plain and ordinary meaning. We interpret legislative intent from the statute as written and will not consider what the legislature might have said or add language that the legislature did not see fit to include. We construe all parts of a statute together to effectuate its overall purpose and avoid an absurd or unjust result. Moreover, we do not consider words and phrases in isolation, but rather within the context of the statute as a whole. This enables us to better discern the legislature’s

intent and to interpret statutory language in light of the policy or purpose sought to be advanced by the statutory scheme. *The LLK Trust v. Town of Wolfeboro*, 159 N.H. 734, 736 (2010).

The approach of the respondents to isolate upon two words, “a board,” is artificially narrow because it is in the operational context of governance that “a board” takes on any meaning within the statute. It is at this juncture where the respondents veer off from the more reasonable interpretation of the statute’s intended purpose to provide for the creation or affirmation of pooled risk management programs established for the benefit of political subdivisions of the state. See RSA 5-B:1. A fair reading of the full statute orients the governance anticipated by the statute to meet the needs of each pooled risk management program and its member political subdivisions; it does not orient the governance to meet the needs of a controlling third party conglomerate. Testimony by respondents’ witnesses and representations by respondents’ counsel throughout the hearing variously and without distinction to refer to “LGC members,” and “program members,” “multiple insurance lines,” and “insurance programs,” “member pools,” and “LGC pools,” reflect a quite liberal disregard for the legislature’s obvious concern for its new creation, “the pooled risk management program.” The statute’s limited focus is on reducing costs of obtaining insurance coverage by New Hampshire’s political subdivisions and on returning the surplus funds of each pooled risk management program to political subdivisions members for the public benefit. The result of adopting the respondents’ interpretation that a board of directors or a board of trustees or a board that did not have the interests of these specially established pooled risk management programs as their direct, primary, if not sole, interest could provide the governance required by RSA 5-B:5, I (b) or as will be later detailed in this decision, would provide the required governance, ignores the import of the legislature’s purpose in creating this special law.

The respondent's interpretation ignores two important points expressed in the statute. First, the beneficiaries of this statute are intended to be our state's political subdivisions as representative of the public benefit. The beneficiaries of this statute are not intended to be the LGC and its members and its other entities. By abolishing each program's respective board and substituting the LGC, Inc. board of directors, the political subdivision members of each pooled risk management program were deprived of the governance previously maintained for their benefit. There can be no reasonable dispute that such an action dilutes the power of the respective members of each program, the health trust and the property liability trust, to control operation and expenditures. The duty of care that is so crucial to legitimate not-for-profit organizational governance and that was previously exclusive to the trust members, thereafter faced competition with members of other LGC entities in existence and potentially additional LGC entities that may be added to the LGC conglomerate. The duty of loyalty that attends board membership also becomes muddled particularly with respect to "fiduciary duties." The evidence differed as to whether there were two or four duties that qualified as fiduciary duties. The LGC, Inc. adopted a "parent/subsidiary" model where the LGC, Inc. took the position that the legal fiduciary duties of board members flowed "up" to the parent. Nevertheless, the LGC, Inc.'s witness Samuels, whose law practice involves considerable corporate and business entity law, testified that fiduciary duties flowed both up and down in the LGC model. Samuels also acknowledged under cross examination that the LGC, Inc. board would have to determine that a decision they planned to make was, "in the best interest of whatever parties they are governing." LGC witness McCue said all fiduciary duties run up to the parent, noting also however that "under the structure of a single member LLC and in exercising that power [the LGC, Inc. board] has obligations [to the trust members]." Indeed, considering all of the testimony of actual board members that testified, the LGC, Inc. board seems to be continuously "taking off one hat

and putting on another” (Enright); and “deciding what’s best for all the members” (Curro), *i.e.* the members of the health trust and members of the property liability trust and the members of the workers compensation trust. Indeed, decisions would have to take into consideration the other conglomerate entities as well: LGC Real Estate, Inc. and the members of NHMA, LLC and the LGC, Inc. parent organization concurrently.

The second point missed in the respondents’ interpretation of RSA 5-B:5, I (b) is that since the pooled risk management programs controlled by the LGC were existing corporations with separate governing boards at the time they were specifically affirmed as already existing, not created by the statute in 1987, the legislature is charged with that knowledge. Therefore, the legislature knew of the existing structure of the health trust and the property liability trust programs and affirmed them and the other programs, unrelated to LGC, Inc. (then NHMA, Inc.) in existence at the time of passage as each met the requirements of RSA 5-B:5, I (b) and (e).

It should be noted that in the period of time running up to the decision of merger in 2003, including the time period bracketing the alleged separate votes of the boards of the LGC, Inc. and the health trust and the property liability trust, all three corporations were provided advice and counsel, served or staffed by the same individuals. These individuals were Andrews, executive director; Carroll, general or staff counsel; Keeffe, chief financial officer; Parker, health trust manager; Emery, consultant; Reimer, actuary; and more remarkably, Attorney Lloyd, who was retained by LGC, Inc. to provide legal counsel to all three corporations moving towards merger, during the debate and vote of each

corporation, and after the reorganization<sup>17</sup>. These same people all continued to serve the LGC, Inc. conglomerate after 2003. Following the 2003 reorganization an immediate conflict of interest problem arises because of the actions of the LGC, Inc. in eliminating the governing board of each pooled risk management program. By assigning the governance to the LGC, Inc. board of directors the pooled risk management program becomes subject to governing considerations not provided for in the statute. This separate requirement expressed in RSA 5-B:5, I (b) is that each pooled risk management program “shall be: governed by a board.” A reasonable interpretation of the statute should support the express purposes of RSA 5-B and those purposes can be fulfilled without resorting to organizational structure that unnecessarily compromises the interests of political subdivision members in one program or another or places those members’ funds at risk. A separate board governing a pooled risk management program is free to undertake actions that will serve the purposes of the program over which it governs and its duty is to the members of that program. The actions of the LGC, Inc. to install itself as parent over a subordinate subsidiary takes away the independence of a specially affirmed or created entity to govern itself. The influences and interests that would be limited to considerations of a single program and its members, become subject to other influences and interests within the LGC, Inc. conglomerate related to other subsidiary business entities all governed by the one board. As mentioned earlier these influences and interests include: (1) the operation, maintenance, and control of real estate interests of LGC Real Estate, Inc., placing the board in the position of both landlord and tenant; (2) the operation, maintenance and implementation of legislative advocacy and lobbying efforts, and the information, legal advice, training and general support programs of the NHMA, Inc. placing the board in the position of advocate for the approximately one third of the state’s municipalities participating in the workers compensation

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<sup>17</sup> It is also noteworthy that these meetings were closed meetings and the minutes were sealed, at least of the health trust, from circulation to its members until some later time that was not evident from the evidence.

trust or the approximately two thirds of the municipalities who do not participate; and (3) the operation, maintenance and financial success of not a single, but three competing pooled risk management programs absorbed as subsidiaries, placing the board in the position of both borrower and lender.

These and other conflicting roles played by a single board are more fully discussed later in this decision in the context of the acts undertaken by the LGC, Inc. board to transfer and expend funds earned by the each separately registered, single-member managed, limited liability company, pooled risk management program. Also the conflicting roles played in the transfers of funds out of the pooled risk management programs and the failure to return excess funds to the different members of each entity are expanded. It is sufficient here to highlight the nature of the interests of the several entities that continually collide within the structure of a single governing board. Such collisions frustrate an reasonable interpretation of the purposes of the statute as expressed in RSA 5- B:1.

Another requirement of the statute at issue in these proceedings is that each program shall be governed by "written by-laws." RSA 5-B:5, I (e). In New Hampshire the term "by-laws" is commonly understood to mean a governing document of a corporation that mandates internal governance and its external dealings. The Health Trust, Inc., New Hampshire Municipal Association Property Liability Trust, Inc., and LGC, Inc. each had filed its own set of by-laws with the office of the secretary of state upon its establishment and since that time as separate entities albeit in the case of the first two entities as separate limited liability companies. Among the LGC, Inc. and its entities' exhibits admitted at hearing, the limited liability company agreements that now exist between each trust and the LGC, Inc. appear not to have been executed until October 20, 2011, after these proceedings were initiated. Maura Carroll, the then executive director of LGC, Inc. signed for both parties to each agreement, without an

accompanying witness signature. Neither of the limited liability companies had the benefit of an “arms length” agreement with the LGC, Inc. and each lacked an operating agreement until eight years after the 2003 reorganization. At the time the LGC, Inc. undertook to transfer assets into limited liability companies it did not create written operating agreements for those companies and did not elect to nor allow those companies to be governed by a board of managing members, but rather chose to operate the limited liability company using a single member option and that single member was the LGC, Inc. This action critically diminishes the authority and control the members of each respective program have over the operation of each program and over the specific pool of earnings and surplus belonging to each program.

The position that the respondents would have the hearing officer adopt does not allow the statute to be read in its full context nor allow the hearing officer to derive a reasonable interpretation from its provisions. It would require an unreasonable interpretation to believe that the legislature had this winding trail of governance transfer and authority dilution in mind when it stated that each pooled risk management program shall be “governed by a board” and “governed by written by-laws” that the legislature saw in place at the time it specially authorized such pooled risk management programs.

Therefore, the hearing officer finds that the LGC, Inc. and its health insurance and, now, combined property liability and workers compensation insurance pooled risk management programs that were affirmed or enabled by the passage of RSA 5-B have not met and presently do not meet the standards related to organizational governance as contemplated and provided by RSA 5-B and therefore these entities have violated RSA 5-B:5, I (b) and (e). The hearing officer also finds that the violation of these two provisions are not dependent on intent. It does not matter whether it was through ignorance,

poor counsel, poor consultant advice or design that the LGC, Inc. and its entities did what they did. It was and is the above actions relating to governance that violated and continue to violate RSA 5-B:5, I (b) and (e).

There may be other consequences of these transactions and asset transfers, but this decision makes no determination, as it should not, regarding the tax consequence, if any, of the events stemming from the attempted transfer of corporate funds, or any tax effect on the pooled risk member's assets, or any effect on the Internal Revenue Code Section 115 governmental exclusion or not-for-profit status of the LGC, Inc. or of its operation of the limited liability companies it has created that may lack non-profit status, all due to and continuing from the conglomerate's reorganization.

*Improper expenditure and failure to return*

The examination and determinations that follow concern violations of RSA 5-B:5, I (c), relating to the actions undertaken by the LGC Inc. and its entities and the individuals named as the respondents in the operation of the pooled risk management programs. In this section of the decision, the hearing officer uses the terms "health trust," "property liability trust," and "workers' compensation trust," to refer to each LGC, Inc. controlled RSA 5-B entities. Any other intended meaning of these terms will be obvious from the context in which it may appear below.

A key requirement of the statute is stated quite succinctly. RSA 5- B:5, I (c) requires that health trust and the property liability trust, "[r]eturn all earnings and surplus in excess of any amounts required for administration, claims, reserves, and purchase of excess insurance to the participating political

subdivisions.” Generally, when called upon to interpret a statute, we interpret the statute not in isolation but in the context of the overall statutory scheme and if the statute has not defined language used within it we look to the plain and ordinary meaning of its words.

The BSR alleges that this particular requirement of RSA 5-B was violated by the LGC because excess returns and surplus were not returned to the respective members of the health trust or the property liability trust. The failure to return funds is alleged to have occurred primarily through actions of the LGC and its entities that resulted from the methods it employed relating to the calculation of reserves and the accumulation of funds from the pooled risk management program members and by the retention of an unreasonable amount of those members’ funds. The BSR also alleges that this requirement was violated by actions undertaken by the LGC and its entities relating to the expenditure of funds for purposes other than those required for the statutorily permitted expenditures of each pooled risk management program controlled by the LGC. The BSR also takes issue with the method by which any return to a program’s members is made.

The respondents essentially maintain that the statute does not set either a specific numeric expression delineating “excess” nor set a maximum level for earnings and surplus above which the LGC is required to return funds of each pooled risk management program to that program’s members. The respondents assert that the board of directors of LGC have the authority, under the governing bylaws of that corporation, to utilize its discretion to set what it determines to be the amount of excess funds required by statute to be returned to the members of each pooled risk management program and to determine the method by which any such amount of funds is to be returned. The respondents further

maintain that the business judgment exercised by the governing board of directors and the management of LGC is sufficient to defeat liability for any violation of the requirements of this statutory provision.

The weight of evidence submitted indicates that each pooled risk program at issue in these proceedings, *i.e.* health trust, property liability trust, and workers' compensation trust, operates generally like a mutual insurance company with the net assets of each program the property of its respective members. For example, the health trust (1) collects premiums; (2) issues policies; (3) settles and pays claims through a third party administrator; (4) maintains loss prevention programs; (5) has returned earnings; and (6) has purchased reinsurance.

The steps involved in the acquisition of insurance coverage by a political subdivision from, for instance, the health trust would appear quite basic. A political subdivision would apply for membership in a pooled risk management program. Information relating to the group of individuals being insured is submitted for evaluation and rating. Upon approval of the requested insurance coverage for the ensuing coverage year that political subdivision would be assigned a premium rate and assigned to either a January pool of program members or a July pool of program members depending, usually, on that political subdivision's fiscal year or requested coverage year. The premiums of all program members would be collected by LGC, Inc. Any claims would be handled by a contracted third party administrator and in the case of the health trust, the third party administrator is presently Anthem Blue Cross/Blue Shield. From the earnings of each trust program under the statute the LGC is entitled to deduct expenditures, "required for administration, claims, reserves and the purchase of reinsurance." RSA 5-B:5, I(c).

Earnings and surplus of each trust are to be determined annually at the end of the coverage year by subtracting the above expenditures from the total amount of the program's income from investments of that program's contributions plus the combined premiums paid into the program by its members. Because the LGC, Inc. is a not-for-profit entity<sup>18</sup> the term "earnings" and not the term "profits" is used. The following salient lexicon is helpful to the interpretation and application of the RSA 5- B:5, I (c) requirement. "Earnings" means: "1 a: something earned as compensation for labor or the use of capital; b. the balance of revenue for a specific period that remains after deducting related costs and expenses incurred – compare PROFIT." Webster's Third New International Dictionary, p. 714, ©2002, Merriam-Webster, Springfield, Massachusetts. "Surplus" means: "1 a: the amount that remains when use of need is satisfied; b: an excess of receipts over disbursements." *Ibid.* p.2301. "Excess" means "1 a: a state of surpassing or going beyond limits: the fact of being in a measure beyond sufficiency, necessity or duty." *Ibid.* p.792. It is significant to note that the terms "surplus" and "excess" each contains an aspect of need or necessity.

The pooled risk management program being referred to as the "health trust" is by far the largest source of revenue for the LGC, Inc. As of December 31, 2010, the last year for which an audited financial statement was provided at hearing, the health trust had revenues of \$392,244,000.00<sup>19</sup>; the property trust had \$10,254,000.00; and the workers' compensation trust had \$6,517,000.00. The year-end statements for years 2008 through 2010 report that the health trust had net assets of \$92,687,000.00 in 2008, \$79,481,000.00 in 2009, and \$86,782,000 in 2010. The property liability trust had net assets of

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<sup>18</sup> Whether the separately filing limited liability companies, as separate entities, are properly designated not-for-profit entities by the LGC, Inc. is not at issue in these proceedings.

<sup>19</sup> For the years 2004-2010 the LGC, Inc. board voted to transfer 1% of the annual gross revenues of health trust to the LGC, Inc. to fund what it referred to as its "strategic plan."

\$10,093,000.00 in 2008, \$10,838,000.00 in 2009, and \$10,225,000 in 2010. The workers' compensation trust had net assets of \$829,000.00 in 2008, a negative net asset level expressed as (\$992,000.00) in 2009 and net assets of \$177,000.00 in 2010.

The statute cannot be reasonably interpreted to have established a limit on the revenues that the health trust receives from its products. The statute cannot be reasonably interpreted to have established a limit on the annual earnings received from premiums paid and a program's investments. However, RSA 5-B:5, I (c) provides that any amount of earnings and surplus retained or maintained by health trust, or any pooled risk management program provided for by the statute, must be returned to the program members in an amount that exceeds the amounts required for "administration, claims, reserves, and purchase of excess insurance." In so stating, this provision establishes an express limit on what the health trust program can retain before it must return funds to its members. It is the amount in "excess." It must be remembered that "excess" means "1 a: a state of surpassing or going beyond limits: the fact of being in a measure beyond sufficiency, necessity or duty." *Id. Webster's*. The LGC, Inc. takes the position that excess is whatever its board decides to declare. It bases its position on the authority it says it acquires under its own governing by-laws and the failure of the statute to specify a particular numeric mandate establishing at what level an excess accrues. However, to adopt that position would lead to a result contrary to the statute's limited purpose and provide an open opportunity for unreasonable conduct by a pooled risk management program or by an entity that has gained control of the enormous revenue generated by such a program as the health trust. To believe that the legislature intended that there be no limit on the amount of earnings and surplus a pooled risk management program, e.g. health trust, can deem "required" before returning an excess to the political subdivisions is not a reasonable interpretation of the statute. This is to say that merely because the statute is does not contain a specific

numeral does not mean there is no limit to the amount the LGC entities can properly retain and withhold from the pooled risk management program members. A hearing officer need not add words that the legislature did not use to assign meaning, but certainly can determine, after considering the weight and credibility of the evidence presented over the course of ten evidentiary hearing days, an amount that would satisfy a reasonable interpretation of RSA 5-B:5, I (c). What has been called a golden rule of statutory interpretation provides that, when one of several possible interpretations produces an unreasonable result that is a reason for rejecting that interpretation in favor of another which would produce a reasonable result. 2A Norman J. Singer & J.D. Shambie Singer, *Sutherland Statutory Construction* § 45:12 (7th ed. 2007); *In re Malouin*, 155 N.H. 545, 552 (2007); see also *St. Regis Paper Co. v. New Hampshire Water Resources Board*, 26 A.2d 832, 840 (1942); *Dearborn v. Town of Milford*, 120 N.H. 82, 85 (1980).

One way by which a reasonable amount of excess to be maintained for a New Hampshire health trust program could be determined is to look to other statutes within our jurisdiction. A similar statute governing the pooled risk management program operated by the State of New Hampshire primarily for state employees does set the amount that can be accumulated and retained at a minimum of 5% of estimated annual claims and administrative costs of that health plan plus an actuarially determined amount necessary to fund the unpaid portion of ultimate expected losses, including incurred but not reported claims, and related expenses incurred in the provision of benefits for eligible participants. (See RSA 21-I:30-b). The LGC, Inc. distinguishes this statutory approach as unlike the situation it faces with the operation of its health trust because it asserts that if the state makes an actuarial mistake and the claim losses exceed the claim premiums, the legislature “can just go to the general fund” to make up the difference. The hearing officer does not share the same degree of

distinction the LGC, Inc. and its entities make. Any distinction would appear to be one of degree and not kind. The state has a general fund and each political subdivision has a general fund. Legislative bodies at either level would view such recourse with any greater or lesser degree of ease. The premiums of the health trust are recalculated on an annual basis by which any deficiency, in the event one occurred, could be addressed<sup>20</sup>. Also, the LGC, Inc. allows funds of any of its subsidiary entities to be available to another entity using an inter-company loan policy it has adopted. This would also include the ability to borrow against the equity in its LGC Real Estate Inc. which holds the land and building at Triangle Park in Concord on which there is no mortgage and is carried on its books at a value of \$10,000,000.00.

The statute also does not expressly prescribe a particular method of computation to be used by a pooled risk management program to compute the amount of earnings and surplus, that is “in excess of” its permitted RSA 5-B:5, I (c) deductions. Four methods for calculating amounts retained by a pooled risk management program were referenced during the hearing: percentage of claims; percentage of premiums; stochastic modeling; and a “rate based capital” (RBC) ratio. The object of each of the methods is to measure the financial well being of an entity like the LGC trusts. The critical need to maintain viability as a pooled risk management program is to have, at an absolute minimum, sufficient earnings and surplus to cover claims loss and the costs of administration of claims. The BSR’s qualified expert (Atkinson) expressed his preference for the stochastic modeling approach to make a determination of the financial well being of the health trust. He characterized it as an approach specifically addressing, in this instance, the health trust and resulting in a more precise figure to

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<sup>20</sup> In all years reported at hearing the combined premiums of all health trust members exceeded the cost of claims loss for which the trust was responsible.

determine the “excess” reserves required for the LGC health trust.<sup>21</sup> He contends that stochastic modeling is a more conservative approach than the more one-size fits all dimension or construct of the generic RBC model employed by LGC, Inc.. Applying his methodology, he concluded, after reviewing relevant figures available to him, including the audited financial statements of the LGC and its entities, that the amounts being retained by the health trust were substantially in excess of what was required to meet the permitted costs of RSA 5-B:5, I (c). Mr. Atkinson’s testimony is found to be that of a qualified expert regarding the finances related to the operation of insurance programs, including pooled risk management programs, and computation and utilization of an RBC index. The specific amount resulting from his use of a proprietary stochastic formula not shared with the respondents and therefore not subject to proper cross-examination, lacks sufficient weight that it might otherwise be assigned for the specific mathematical conclusion that a reasonable ratio for the LGC, Inc health trust would be RBC 2.1. That he is qualified to analyze or compute an RBC ratio is not questioned. That he is qualified to examine the financial information provided by the LGC, Inc. and ascertain amounts of net assets and other categories of assets and liabilities is not questioned. He is qualified to render an opinion as to the amount of net assets held by the LGC, Inc. controlled health trust.

He allowed that the other methods of calculation are used or have been used in the insurance industry and that the RBC ratio is recognized by and used by all state insurance commissions in their regulatory assessments of the financial strength of entities under their oversight authority.<sup>22</sup> The RBC ratio represents a level of capital that regulators have determined an insurance entity should hold, based

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<sup>21</sup> While the health trust program also offers a dental plan, little evidence was presented by either the BSR or the respondents that indicated that such revenues and costs of that particular line of insurance would substantially affect the issues considered in this decision.

<sup>22</sup> Mr. Atkinson’s uncontroverted testimony regarding the recognition of RBC indicated that the State of New York was at some variance from the nationally recognized RBC index.

upon a formulaic assessment of risks, to protect its members from adverse developments before regulatory action will be taken. The RBC ratio is a number that relates to the amount of authorized control level (ACL), *e. g.* RBC 2.0 is equal to twice, or 200% of the amount of authorized control level (ACL) which is expressed as RBC 1.0 or the equivalent of 100%; RBC 3.0 is equal to 300% of funds necessary to meet hypothetical amount of capital or surplus an insurance company needs.

The LGC, Inc. asserts that since 2003 it has utilized the RBC to set a desired “target” against which it would measure the sufficiency of its net assets. For the year 2010, this was reported as RBC 4.3 or 430% of the LGC health trust’s predicted actual claims loss. (See Table 1, below, for reported actual RBC figure for years provided immediately preceding 2010). The significance of expressing net assets as an RBC ratio can best be understood by remembering that it is merely a regulatory index for use in the insurance industry developed by the National Association of Insurance Commissioners. The LGC, Inc.’s switch to the use of an actuarially based RBC ratio, for whatever reason, as will be detailed later in this decision, was flawed due to its actuarial accuracy being arbitrarily adjusted by the LGC, Inc. board. In rendering this decision the hearing officer considered how the witnesses were using the term as a ratio related to the authorized control level (ACL) figure.

The RBC index numbers have significance only in relation to the actions a regulating authority may undertake. A regulatory intervention would usually occur when an RBC fell below 0.7; between 0.7 and 1.0 a regulator generally has the option to intervene with the entity; and between 1.0 and 2.0 the entity may be required to start filing reports with a regulating authority to reveal how it is managing its program’s capitalization and how it plans to strengthen its capital, or net asset position.

In 1997 the New Hampshire Insurance Commission contacted the then, NHMA, Inc. (now LGC, Inc.) and NHMA Health Trust Inc., although lacking specific legislatively assigned authority, to inquire as to its financial well being in light of allegations of insufficient loss reserves that had been made in litigation unrelated to this instant matter. The commission was assured by the then, NHMA, Inc. and NHMA Health Trust Inc. that the health trust was financially sound. At the time these assurances were made the net asset level of the health trust stood at a level equivalent to RBC 1.22. After being assured of its financial strength by management, the insurance commission withdrew from further involvement. To underscore its financial soundness at the RBC 1.22 level, at that time the chief financial officer, Sandal Keeffe, explained in a memorandum to the health trust members that the line item “member balance” alone was not the sole nor the best measure of the health trust program’s financial strength. Her memo read, “The member balance represents the funds remaining after it has set aside reserves, to pay claims and related costs of operations...The trust believes it has priced its products to remain fully funded and financially sound.” The rationale for soundness at that time therefore took into consideration, members’ balance, claims reserves and administrative costs. The reductions in the RBC ratio from the prior year’s RBC 1.85 ratio had resulted from the introduction of a new insurance product by the health trust that was more costly than expected coupled with a previous decision of the then separate board of trustees of the health trust voting to return some of the amount retained as a capital reserve with the RBC standing at 3.89, *i.e.* excess, to the contributing members of the health trust.

That explanation of the significance of the line item “members balance,” presently labeled “board designated,” is important as it confirms that then, as now, reference to the LGC health trust’s financial statements indicates that the RSA 5-B referenced costs associated with claims loss and cost of administration are sufficiently held and identified in line items other than what has, since the 2003

reorganization, been an amount appearing in “board designated” or “undesigned,” or both, as used by LGC, Inc. from time to time. It is further revealed by an examination of the health trust’s annual financial statements for years 2003-2009 that an additional amount of health trust funds were set aside in still another line item linked to another RSA 5-B permitted cost, that of the cost for the “purchase of reinsurance.”<sup>23</sup>

That equivalent<sup>24</sup> of RBC 1.22 is the lowest the health trust has experienced since 1997. By 2002, the RBC equivalent ratio for the net assets being held by the LGC stood at RBC 2.8, or 280% of its actual claims loss at that time. For other years since the 2003 LGC reorganization that changed the structure and the operation of the health trust, the equivalent RBC ratio was as follows:

Table 1.

YEAR	NET ASSETS (as % of claims)	RBC
1994	30.2	5.08
1995	23.4	3.89
1996	10.8	1.85
1997	7.6	1.22
1998	14.2	*
1999	19.3	*   *not converted to RBC equivalent by any party
2000	15.4	*
2001	16.0	*
2002	14.2	2.8
2003		2.6 (first year of reorganized LGC and entities)
2004		3.6
2005		4.5
2006		6.0
2007		6.7 (first rate reduction for health trust members by “parent”)
2008		6.4 (rate reduction suspended after one year of planned 3 years)

<sup>23</sup> The LGC board voted to abandon its past practice of purchasing reinsurance for 2010 and instead assumed the full responsibility for all amounts of claims regardless of amount, thereby eliminating protection from unusually high or catastrophic losses.

<sup>24</sup> In 1997 the LGC, Inc. (formerly NHMA, Inc.) did not use the RBC method, it used the percentage of claims method.

2009	4.8 (first year after financial information filings required)
2010	4.3(first year after amendment to authorize investigations)

The above list reveals the rapid rate at which the health trust accumulated earnings from their members' premiums and investment income over the span of years portrayed. It reveals what is reported as a substantial drop immediately preceding the statutory assignment of reporting and investigation authority responsibility within the office of the secretary of state. It also reveals that when it reached its lowest amount of net assets expressed as a percentage of claims (1997) it was able to essentially double that figure within one year.

A corresponding list showing, in dollar amounts, the funds reported by LGC, Inc. for the health trust represented by the above RBC ratio and the precipitous depletions of additional funds set aside in the line item "undesignated<sup>25</sup>" significantly after the 2009 and 2010 amendments to RSA 5-B appears below:

Table 2

YEAR	BOARD DESIGNATED	UNDESIGNATED	TOTAL NET ASSETS
2003	N/A	\$23,944,000.00	\$24,965,000.00
2004	N/A	\$24,873,000.00	\$39,920,000.00
2005	N/A	\$56,303,000.00	\$56,302,000.00
2006	\$60,766,000.00	\$16,248,000.00	\$77,234,000.00
2007	\$64,528,000.00	\$25,047,000.00	\$91,529,000.00
2008	\$68,311,000.00	\$25,723,000.00	\$92,687,000.00
2009	\$77,885,000.00	\$ (757,000.00)	\$79,481,000.00
2010	\$84,412,000.00	\$ (974,000.00)	\$86,782,000.00

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<sup>25</sup> The Executive Director from 1976 to 2009, John Andrews, testified that he considered the funds appearing in the "undesignated" line as "free excess."

It is notable that over a similar, 2004-2010, span, the LGC, Inc. as a stand-alone entity reveals operating losses in the approximate amount of \$7.5 million.

The respondents place undue significance on information appearing in reports regarding the RBC ratio numbers that have been attributed to insurance companies in other states. RSA 5-B explains that the purpose, in part, of the statute is to establish these pooled risk management programs and lower insurance costs by predicating them, “solely on the actual experience of political subdivisions within the state.” RSA 5-B:1. Therefore, special attention must be paid to the surplus retained by the health trust or other LGC programs operating here in New Hampshire. These reports were undertaken for purposes other than this instant matter, and lack supportive evidence that any of the jurisdictions, in the case of the Pennsylvania report, or the combined list of profit and non-profit insurance-like entities operating in Massachusetts, are subject to a statute like ours that mandates a return of funds to political subdivisions in excess of the costs of administration, claims, reserves and purchase of reinsurance. References to the RBC ratio included for each of the jurisdictional entities included in the Pennsylvania report or the mixed profit/non-profit entities in the Massachusetts report further decrease the weight of these studies as evidence. This is so because of the minimal comparative value between so-called “targeted” RBC ratio interspersed in these reports and the “actual” RBC ratio that bears a closer relationship to the level for a return of earnings of the health trust required by our statute. The non-existence in these other jurisdictions of a statute similar to RSA 5-B in its design and intent to restrict retained earnings diminishes the evidentiary weight of these reports. Also the statutory distinction comparing the cost of a pooled risk management health program based solely upon a New Hampshire political subdivision’s group of individuals, census, population, “live bodies,” or as colorfully referenced at hearing, “belly buttons,” to a dissimilar collection of “belly buttons” in other states like Pennsylvania, Massachusetts,

Michigan<sup>26</sup>, and the like has little evidentiary value. The reason for this being that the risk inputs used to calculate the RBC ratio of these other states' populations or groups is different as indicated by the testimony of LGC, Inc. actuary, Peter Riemer. While reference to other entity's within an industry may be considered in determining a reasonable level of retention because of the distinguishing categorical differences between these jurisdictions and entities, which are cited by the LGC, Inc. and its entities, and the pooled risk management programs here in New Hampshire and at issue in these proceedings, they essentially eliminate their consideration for such purpose.

Reference to the figures appearing in the above tables show that since the 2003 year-end, following the reorganization into the so-called LGC "parent/subsidiary" model, the amount previously labeled in the health trust financial statements as "members balance," then "undesignated," and finally, "board designated," increased by approximately 350% by 2010. In addition, funds were also transferred to the line item "undesignated" from 2006 forward amounting to an additional \$25,723,000.00 before depletive transfers were made to this long standing line account. This account was essentially depleted by LGC, Inc. by electing to use this account line item to fund what it reported as additional claims losses in the approximate amount of \$8.8 million; transferring approximately \$4.4 million to the LGC, Inc. itself. These transfers, occurring in 2009, are also coincident with the requirement for financial filings with the secretary of state becoming effective pursuant to the 2009 amendment to RSA 5-B. These undesignated funds were referred to as "free excess" by the former executive director, who coincidentally also moved his retirement up to September 2009.

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<sup>26</sup> The report states that Michigan has a maximum RBC rate of 10.0 that an insurance company can retain. This RBC 10.0 ratio is an extreme level never having been reached by the plan.

In the next year, breaking pattern, no funds were assigned by the LGC, Inc. into the previously funded “undesigned” account. Reference to Table 2, above, reveals a significant boost to the board designated account however. Earlier in that same year the additional investigative authority was assigned to the secretary of state pursuant to the 2010 amendment to RSA 5-B. The credible and qualified testimony of BSR witness Atkinson permits the finding that the essential elimination of the funds that ordinarily would have been assigned to this account was accomplished by an inexplicable increase within that year’s calculation of risk factors by the LGC, Inc. actuary or staff. Contrary testimony to the extent that there is any, lacked such credibility. Viewed in context, even allowing for some amount claimed by LGC, Inc. to have been used for a partial “rate stabilization” of health trust premiums, the sudden diminishment of approximately \$25 million in “undesigned” or “free excess” account funds to address transfers or expenditures rings hollow. But the many years during which that account was funded gives some indication of funds that were in excess even beyond the substantial funds the LGC, Inc. board assigned to the health trust “board designated” asset account. Again, it should be kept in mind that the amounts held even in this board designated account were beyond those funds necessary to satisfy claims loss, including those incurred but not reported, and the administration of those claims which were assigned to other line item accounts.

By December 31, 2010 the LGC, Inc. had accumulated and was retaining \$86,782,000.00 as net assets or over 430% (RBC 4.3) of its actual claims loss. These net assets derive from the earnings of the health trust and surplus allowed to accumulate from the premiums paid by the member political subdivisions and investment income. These remaining net assets when added to the substantial amount of funds transferred out of the health trust to LGC, Inc. represent an amount of earnings and surplus that may reflect a very successful “for-profit” business, free in this instance of regulation by the insurance

commission and exempted from paying any tax. This amount of retention does not reflect the proper operation of a statutorily authorized special pooled risk management program whose purpose, in part, is to return excess earnings and surplus to the members of the health trust as required by RSA 5-B:5, I (c).

The key to understanding how the LGC and its entities violated the provisions of RSA 5-B:5, I (c) lies in certain actions or practices of the LGC that caused an unnecessary and unreasonable diminishment in the amount of funds in the health and property liability pooled risk management programs that should otherwise have been considered excess and returned to members of each of these trusts. These LGC actions or practices fall into two broad categories: (1) improperly expending and transferring funds from the health trust and to a lesser extent from the property liability program; and then, (2) retaining an unreasonably large amount of earnings and surplus within the LGC and its entities thereby withholding it from return to political subdivision members.

One of the several actions undertaken by the LGC management and board that diminished the earnings of each program otherwise available for return to members was to take \$500,000.00 from the health trust and \$500,000.00 from the property liability trust in 2000 to fund a separate workers' compensation trust. These amounts were transferred from the health and property liability program accounts by the LGC, Inc. (at the time, NHMA, Inc.) and constituted excess funds that the statute contemplated were to be returned. They qualified for return because the statute cannot reasonably be interpreted to allow such a transfer of funds to fall within any one of the statute's four allowable deductions, *i.e.* administration, claims, reserves or the purchase of reinsurance. RSA 5-B:5, I (c). In addition, those transfers from each program was made without contemporaneous consideration given to

each existing program and without express permission of each political subdivision member of the health or property liability programs to which the funds “belonged.”

Another action taken by the LGC and its entities that diminished the excess earnings and surplus of the health trust and property liability trust programs was, and is, the continuous practice of taking funds from the health and property liability programs to subsidize the operation of a workers compensation pooled risk management program that was financially deficient, *i.e.* insufficient premiums were paid to cover all claims and administration of claims costs. The extent of the deficiency of this program became less obvious to casual financial review when, in 2007, it was merged with the property liability trust which allowed it to exceed financial minimum levels required by the department of labor. This workers’ compensation program also was comprised of a different set of political subdivision members. These periodic transfers out of the health and property liability accounts to subsidize another program were done in violation of a specific inter-entity loan policy that existed to govern transfers within the LGC and its entities and without compensation to the health trust and the property liability trust<sup>27</sup>. Further, the LGC, Inc.’s manner of reporting these transfers as “contributions to parent” on the financial statements of the health trust and property liability trust made it unnecessarily difficult, as did other referencing, *e.g.* strategic contribution, for a member reviewing the financial statement to discern the actual purpose of the transfer as a subsidy, in whole or in part, for a separate pooled risk management program to which that member did not subscribe. Table 3, below, displays the amounts for

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<sup>27</sup> After an investigatory report on these actions by the BSR, the LGC board voted to execute a promissory note payable to the health trust in an amount of \$17,111,804.35 million. However, it did so making the note interest-free despite the recommendation of its new executive director that it be interest bearing and without a fixed temporal duration for the note. The provisions of this note violate the express policies of the LGC and its entities regarding inter-entity loans.

the years indicated that the LGC, Inc. transferred funds out of the respective pooled risk management programs as named.

TABLE 3

YEAR	Contribution by Health Trust to LGC, Inc. (parent)	Contribution by Prop. Liability to LGC, Inc. (parent)
2003	\$ 3,930,000.00	\$ 1,398,000.00
2004	\$ 1,013,000.00	\$ 34,000.00
2005	\$ 2,675,000.00	\$ 438,000.00
2006	\$4,181,000.00	\$ 160,000.00
2007	\$4,501,000.00	\$ 20,000.00
2008	\$6,545,000.00	\$ 758,000.00
2009	\$4,431,000.00	\$ 179,000.00
2010	\$3,875,000.00	\$ 150,000.00

It is from these contributions to the parent, that LGC, Inc., chose to subsidize its workers compensation program. The exact amount of these funds directed to subsidize the workers' compensation program from the health trust through December 31, 2010 are difficult to ferret out from the state of the financial statements entered into evidence. A qualified BSR witness, Coutu, testified at hearing that the subsidy from the health trust amounted to approximately \$18.3 million.<sup>28</sup> These represent funds that, if not transferred as improper subsidy payments, could have been returned to the members of the health trust and members of the property liability program, in whole or in part, during the years in which they were transferred, or can be returned presently as excess earnings and surplus.

A third action undertaken by the LGC and its entities relates to the transfer of ownership of certain real estate in 2003 from the health trust, having a 75% interest, and the property liability trust,

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<sup>28</sup> The workers compensation program was merged with the property liability program in 2007 and any prior subsidy contributed by the members of the property liability trust to the workers' compensation program are deemed to currently remain as surplus within the combined program.

having a 25% interest, to another LGC entity, namely LGC Real Estate Inc. without any compensation to the two trust programs. The value of the real estate at the time was approximately \$5,000,000.00. This was not a purchase of this real estate from the two programs, but a transfer or conveyance without compensation paid to the two programs that also represents a diminishment of earnings that could have been available for return to program members and a benefit to the LGC, Inc. and its other entities. Although not stated as its present fair market value this real estate is presently carried "on the books" at a value of approximately \$10,000,000.00 by LGC. Adding to the adverse financial effect of transferring the real estate ownership away from the health trust and property liability trust programs is that the LGC, Inc. management and board requires each program to pay rent to LGC Real Estate Inc. that inures to the economic benefit of LGC, Inc. and its other entities. Further, while the LGC argues that its other entities also pay rent at the same rate proportionate to the space that each occupies, those other entities did not have any ownership interest in the real estate before the transfer to LGC Real Estate Inc. In addition to losing title to the real estate, the LGC and its entities thereafter transferred approximately \$3,000,000.00 from the health trust for improvements to the real estate, again from funds that otherwise could have been returned to its political subdivision members, in whole or in part and could presently be returned.

There is a last insult in this string of actions undertaken by LGC, Inc. and its entities that diminished the earnings and surplus that otherwise could have been returned in whole or in part to the health program and property liability program members. The LGC, Inc. entered into agreements with two unrelated entities that requires LGC, Inc. and its entities to provide free office space. With one of these unrelated entities, the New Hampshire School Boards Association (NHSBA), the LGC, Inc. committed itself to an additional annual service payment to the NHSBA in the amount of \$68,000.00;

plus \$10,000.00 annually for sponsorship of the school board association's website; plus \$5,000.00 annually to support publication of a handbook for the school board; plus up to \$40,000.00 annually to support the salary of a school board association staff attorney position; plus up to \$10,000.00 annually to fund a new staff position for the school boards association. This last contribution was to obtain the provision of "coverage" or short term assistance at various times, *e.g.* during lunch breaks or during meeting attendance, for LGC, Inc. and its employees. This agreement with the New Hampshire School Boards Association is to last for approximately ten years through 2014. While the LGC can point to receipt of some shared receptionist-type services as part of that agreement, such services as described are reciprocal as the LGC provides similar services to that association and represent minimal, if any, financial compensation to the pooled risk management programs from which the real estate was transferred. The other entity, Municipal Bond Bank, is provided rent-free occupancy while the health trust and property liability trust are required to pay rent to a "landlord" who previously acquired the property from them without paying compensation.

There are also several other actions that have been undertaken by the LGC, Inc. and its entities that required, and to an extent continue to require, the LGC, Inc. and its entities to expend money that diminishes earnings and surplus that could in whole or in part be returned to the members of the health trust and the property liability trust. These actions do not amount to such large fund depletions from the health program and property liability programs as those actions described above. But they do reveal the financial magnanimity that appears to have enveloped the LGC, Inc. after the 2003 reorganization that gave the LGC, Inc. board and management direct authority over all health trust and property liability trust revenue, earnings and surplus. Soon after the reorganization of the LGC, Inc. and its entities and the continuing practice of improper fund transfers and expenditures, the LGC, Inc. board established and

contributed a fixed benefit retirement program for its employees at a specific cost that could not be determined from the evidence. LGC, Inc. also approved a consulting agreement for its former executive director upon his retirement in the amount of \$100,000.00, in annual increments of \$20,000.00. The LGC, Inc. and its entities adopt the position that this was an “arms length” agreement with fair consideration provided by each party. However, notwithstanding that it was allegedly executed for the provision of consulting services, no such services were provided by this former executive director. The LGC, Inc. and its entities’ adopt a supplemental position that the payment to him was also in exchange for a non-competition agreement preventing him from providing essentially the same services to others that he did for LGC, Inc. and its entities. His testimony did not represent that his retirement was due to the enforcement amendments added to RSA 5-B, but that it was actually moved up from its later planned date because of health reasons, from which it can reasonably be inferred would inhibit, in whole or in part, his continued performance of consulting in the sophisticated and stressful areas of activity described in a non-competition clause of his agreement. His adverse health reasoning for retirement at that time stretches the credulity of this LGC, Inc. argument.

Each of the actions described above and the related transfers and expenditures of funds constitute violations of RSA 5-B:5, I (c) by improperly removing funds from the two pooled risk membership programs that represent earnings and surplus that are required to be returned as excess to the political subdivision members of each program because these amounts do not reasonably qualify as costs and reserves permitted to be retained by the statute.

Two basic points deserve reiteration before discussing a second set of practices employed by the LGC, Inc. that results in the LGC, Inc. and its entities withholding excessive funds instead of returning

them as excess to health trust members. First, the statute's formula for returns is straightforward, *i.e.* Earnings + Surplus – (costs of administration + costs of claims + reserves + cost of reinsurance) = Amount returned to member political subdivisions. RSA 5-B:5, I (c). And second, the LGC, Inc. is a not-for-profit organization that controls the health trust, a pooled risk management program, specifically created by the statute to provide certain insurance coverage for New Hampshire's political subdivisions at a lower cost and with anticipation of returns to the members for the public benefit.

The LGC, Inc. and its entities take an obvious position that the more capital, or net assets, an entity has the better for that entity. However, the purpose of the statute is not to allow LGC, Inc. and its entities to acquire and retain unlimited millions of dollars in excessive earnings and surplus, building equity as a private for-profit corporation might. The LGC, Inc. by-laws were amended to provide that "upon dissolution [of the health trust, property liability trust] the assets of each trust would be distributed to its members." However, the statute cannot be reasonably interpreted to have intended such a distribution to solely satisfy the return of excess required in RSA 5-B:5, I (c). Further, dissolution may never occur. If it were to occur at some unspecified future date it would be difficult, if not impossible, to assure member political subdivisions that they would be fully and proportionately provided the accurate shares of those funds. The LGC, Inc. has admitted a policy of not retaining records of its financial operation in perpetuity and of computer record failure that has resulted in lost relevant financial data. Also, there are innumerable ways by which such retained earnings and surplus could become encumbered or, given LGC, Inc. history of expenditures or transfers of contributions out of the health and property liability pooled risk management programs, simply spent or "loaned" without interest for other purposes.

The LGC, Inc. and its entities made decisions following the reorganization that resulted in it acquiring approximately \$1.1 billion dollars from the premiums paid by the health trust members from its parent/subsidiary reorganization in 2003 through 2010. It returned only 2.7% or \$30.2 million of that amount to the members as excess during that same period while it increased its own net assets from \$24.9 million to \$86.8 million. This juxtaposition of LGC, Inc. organizational benefit for the little benefit to political subdivisions, that are supposed to be the statutory beneficiaries of the success of the RSA 5-B programs, is a result that is indicative and reflective of the LGC, Inc. substituting its own desires for the statutory needs provided for by RSA 5-B:5, I (c). Reference again to Table 1 shows the ironic growth in earnings and surplus retained by the LGC, Inc. and management during a period when members were able to hold funds in their own accounts to provide a “buffer” or “cushion” for the ill financial winds that have and continue to buffet them in the past decade.

There are two factors contained in the statutory formula for returns that do not merit much discussion. These are two of the costs within the above formula for which the LGC, Inc. controlled trusts are permitted to retain funds before making returns to the program members: (1) the cost of claims; and, (2) the administrative costs associated with the processing of those claims. The BSR did not offer any evidence showing that the amounts paid for actual claims by the health trust were excessive or improper so there is no finding that the statutorily permitted deduction for claims was violated. Also, there was insufficient evidence submitted to establish that the costs of the administering claims of the pooled risk management program were excessive or improper. The BSR expert witness, Atkinson, conceded that the LGC, Inc. reporting of the cost of administration at 7.7% of claims was reasonable. There may be issues that remain relating to how the LGC, Inc. may have expended pooled risk funds for administrative costs not required for the specific operation of the pooled risk management programs, *e.g.* alleged costs for

unnecessary litigation and lobbying expenses, but these were not developed at hearing. Therefore no further discussion in this decision is attributed to such other administrative costs or the extent such were necessary to the operation of the pooled risk management program entities, particularly the health trust.

On the other hand, the costs of purchasing reinsurance and setting the retention level of reserves do require more attention. The manner by which the LGC, Inc.-controlled health trust addressed the issue of reinsurance is an example of its operative disregard of the purpose and standards of RSA 5-B. Over time the LGC, Inc. built up its net assets to such a high level that in 2010 it abandoned the practice of purchasing either individual claim or aggregate reinsurance to cover an extraordinarily large individual claim loss or a extraordinarily large combined number of individual claims, that otherwise and reasonably were anticipated by the statute to require pooled risk management programs to purchase reinsurance. Reinsurance to “cap” the amount that will be paid out on a single individual’s claim is a common practice whereby an insurance program will cede to the reinsurer the risk that any individual claim will exceed the cost cap limit set. Another type of reinsurance also purchased by the health trust provided reinsurance for an aggregate claim loss for a coverage period. This occurs when the combined claims loss for all insured “belly-buttons” exceeds a previously fixed aggregate amount during a coverage term. In both instances, the reinsurance provider steps in and assumes the risk that excessive or “catastrophic” losses may happen and pays the claims cost in excess of the agreed cap. This common practice in the insurance industry relieves the primary insurer of having to include such extraordinary calculations in annually setting its risk loss and, in the case of the LGC, Inc. health trust, having to maintain an unreasonably high level of net assets. When the LGC, Inc.-controlled health trust made the decision not to purchase reinsurance it indicated that it was then holding sufficient net assets to take on

the sole and complete responsibility for meeting catastrophes that would result in extraordinarily large claims loss.

For what catastrophes was the LGC, Inc. aiming to increase net assets by retaining members' excess earnings and surplus to cover in the event of their occurrence? The chairman of the LGC, Inc. board of directors provided testimony revealing the level of catastrophes for which he believed the LGC, Inc. health trust had to be prepared. These included catastrophic claims loss ranging from a World War I type pandemic, where 700,000 people died in this country, to a Seabrook Nuclear Power Plant failure. These ruminations lead him to conclude, "I think I'm supposed to think about these things. I think I'm supposed to see that there's a reserve level that will—that will handle whatever comes our way." He proceeded to add, that in view of the recent enormous nuclear disaster in Japan, "... I think I have to consider – not that I think the world's going to fall apart, but it's important that I look out on a distant horizon when we're talking about reserves." The LGC, Inc. actuary's testimony added "terrorist attack" to the panoply of risks the health trust believes it must retain additional members' earnings and surplus rather than pay a fixed premium for reinsurance as anticipated by the statute.

The LGC, Inc. health trust's justification for the decision to abandon reinsurance was that the reinsurance premium constituted an amount of money "going out of the system." Few of us like to pay insurance on our own homes either, but seldom do we assume the risk not to do so. Fewer more would reasonably undertake the option of setting aside enough money to replace our home in the event of a catastrophe; much less do so in the face of the competing needs of our family members. This testimony regarding the size of the events for which it is now prepared evidences the desire and practice of LGC, Inc. and its entities to retain a substantially higher level of reserves than otherwise would be necessary

with reinsurance in place. Again, its limitless approach to the use of reserves puts the LGC, Inc. entities' interests before the health trust members' interest and supports strongly why the purchase of reinsurance was specifically provided for in the statute. The only reasonable interpretation of RSA 5-B:5, I (c) in addressing the operation of the not-for profit entities is that the financial safety provided by reinsurance for the health trust or property liability trust, despite an annual premium cost for that reinsurance, was contemplated to protect the political subdivision members and enhance the potential return to them of surplus. Substituting the higher retention of earnings and surplus to build sufficient reserves to handle "whatever comes our way," instead of the purchase of reinsurance clearly inflates a reasonable and necessary level of reserves or net assets and is a violation of RSA 5-B:5, I (c). No longer needing to maintain such a high level of assets to self-insure against such catastrophic or excess claims also assists in determining a reasonable net asset reserve that more appropriately would be necessary to the operation of the health trust and to determine the amount of net assets that could presently be returned to health trust members.

The remaining issue for examination under the provisions of RSA 5-B:5, I (c) are the practices employed by the LGC, Inc. and its entities in setting a reasonable level of reserves. A reserve is, "money or its equivalent kept in hand or set apart usually to meet a specified liability or anticipated liabilities: as b(1) the portion of an insurance company's assets set aside for some special purpose as evidenced by showing the reserve as a liability on the books." *Ibid. Websters*, p. 1930. It has been cited previously in this decision that the statute does not express a specific numeric, percentage, or ratio, to the level of reserves that qualifies as a permissible deduction. This alone does not make the statute silent, nor abdicate the state's responsibility, and in this matter, its statutory authority to require pooled risk management programs to operate under a reasonable interpretation of RSA 5-B read as a whole. The

LGC, Inc. controlled health trust maintains reserves to cover its anticipated or predicted medical claim losses. As to the amount of funds set aside for these purposes the only issue in conflict appears to involve a difference of opinion between the BSR expert, Atkinson, and the LGC actuary, Reimer, regarding the amount reserved to cover claims that are incurred but not reported (IBNR). The BSR asserts that the LGC, Inc. health trust reserves approximately 10% more than is appropriate for IBNR. However, this difference was not sufficiently developed at hearing and therefore is not part of these findings.

Other funds reserved appear in LGC, Inc. financial statements through the years as first, “members balance,” then “unrestricted,” and then “board designated.” In 2006 the LGC, Inc. health trust began holding funds not in either unrestricted or board designated accounts, but in both as the amount of its net assets increased. Its witnesses testified that LGC, Inc felt it needed more of a “cushion” in case there were unforeseen risks that exceeded the planned claims loss. At the same time that the LGC, Inc. was maintaining this position, its health trust was growing in size and through a theory of probability known to its actuary and the LGC, Inc. staff as the “Law of Large Numbers;” the predictability of loss risk actually decreases with an increase in the number of individuals under coverage. The example provided was a coin toss. The more times you flip a coin, the more likely the ratio of heads to tails will narrow towards a 1:1 ratio.

By 2008, the year prior to the requirement that it make additional filings with the office of the secretary of state, the health trust financial statement reveals a claims loss reserve of \$22,896,000.00, and an additional amount reserved as “board designated” funds of \$68,311,000.00, and still an additional amount reserved as “undesigned” funds of \$25,723,000.00. This last account was that amount

considered “free excess” by the former executive director. The former executive director does not appear far off the mark. That characterization has support in the management discussion and analysis accompanying the December 31, 2006 financial statement. There it indicates that the amount of funds that “met” its own “target” RBC of 4.2 were assigned to a “designated” account, thus leaving this admitted amount in excess of its own reserve target to stand in the undesignated account. It is determined, then, that even when the LGC, Inc. controlled health trust exceeded its own chosen target for net assets, it did not return the excess to the political subdivision members. It improperly retained these funds, truly as its own excess; funds it seems, as in the past, in search of a use.

Another action undertaken by LGC, Inc. that results in it retaining an unreasonably large amount of net assets or excess is its decision to arbitrarily bump its own target RBC 4.2 ratio by an additional factor of approximately RBC 0.5 for future expenses. This adjustment amounted to \$7,100,000.00 in 2006. These administrative expenditures involved contemplated building expansion and improvements, technology system improvements, and other unnamed administrative expenditures. The RBC ratio is supposed to be the result of a risk based analytical formula. An after-the-fact bump of an arbitrary sum the board referred to as RBC 0.5 is an erroneous use of an RBC ratio and is an improper inflation of even its own target RBC 4.2. to cover what in most entities are planned budgeted expenditures. A fair reading of the accompanying financial statement management discussion and the explanation rendered by the chief financial officer at hearing simply points out that at that time the LGC, Inc. health trust had funds available for return to political subdivision members but found another use for them. This other use chosen by the LGC, Inc. board is but another example of the members’ interests being subordinated to the LGC, Inc. board. To borrow a term from the argument of the LGC, Inc. and its entities, after filling all of its “buckets”: claims reserve, board designated account, and the additional undesignated

account, the LGC, Inc. and its entities had an obvious overflow. Yet, its thirst was such that it was going to hold on to the additional \$7.1 million. It was going to retain it because from the chief financial officer's testimony it appears they were going to do something with the money without knowing specifically what amount they were going to spend, or when they were going to specifically spend it. But they were going to use the board's annual rating process discussion and what is supposed to be a relatively exacting risk loss calculation to retain another arbitrary, and non-risk based \$7.1 million. The insult to the health trust program members here is that they very well could have used funds to improve any of their own buildings or improved their own technology systems or set it aside in their own respective lapsed fund accounts, as some eventually indicated that they did want funds returned.<sup>29</sup>

These funds were not fully expensed out for approximately three years, which coincides with the reporting year of 2009, the same year in which financial reporting accountability was imposed on the pooled risk management programs by amendment to RSA 5-B. With the amount of net assets already having been accumulated and continuing to accumulate the retention of an additional RBC 0.5 factor for the above purpose requires an unreasonable interpretation of RSA 5-B generally, and RSA 5-B:5, I (c) specifically, and therefore violates the statute.

Another practice followed by the LGC, Inc. and its entities that indicates that it has retained earnings and surplus in excess of the four permitted deductions of administrative costs, claims, reserves and purchase of reinsurance involves the nature of its investments. While acknowledging that the LGC, Inc. health trust has adopted an investment policy, the policy permits an investment strategy that is at odds with the purposes of a return of excess to political subdivision members. Health insurance is

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<sup>29</sup> Prior to the hearing several political subdivision members of the health trust made specific requests for a return of funds related to transfers of funds out of the health trust, through the LGC, and into a separate entity to subsidize a deficient workers' compensation program, *e.g.* Dover, Portsmouth.

referred to as an insurance coverage that has a short tail because you know within a relatively short period of time after the claim what its cost will be. The petitioner and respondents agree to this “short tail” characterization while they differ slightly in stating just how long is a short tail. I find that a period of three years following a claim would constitute a sufficient period to accommodate a short tail coverage, based upon the testimony of Coutu and Emery, and in an affidavit provided by Emery in another proceeding but provided as an exhibit here.

When one looks at the investment holdings of the LGC, Inc. health trust, a not-for-profit entity with the purpose of providing lower cost health insurance and with the purpose also of returning earnings and surplus to its members, one would expect that the investments would somewhat mirror the three-year short tail period. It is during these three years following a claim, that almost all claims that are made tail off, and those few remaining will carry costs that are predictable. To have funds invested beyond the three year period would be funds that, if needed, could not be obtained without the so-called “breakage cost” of prematurely terminating a planned investment return, that is, selling before a scheduled maturity or redemption period. The LGC, Inc. financial statements reveal that for the last three reported years available at hearing the health trust’s funds were: in 2008, \$63,543,103.00 invested with 44.6% placed in investment vehicles in excess of 5 years; in 2009, \$57,020,943.00 were invested with 49.2% placed in investment vehicles in excess of 5 years; and in 2010, \$45,892,240.00 were invested with 80.8% placed in investment vehicles in excess of 5 years.<sup>30</sup> To have these large sums invested in such longer term investments is another indication of the excess earnings and surplus available and retained by the LGC, Inc. health trust and is an improper retention that violates RSA 5-

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<sup>30</sup> These investments exclude cash and cash equivalents immediately available to LGC health trust during the same three years of \$54,243,103.00 for 2008; \$41,698,180.00 for 2009; and \$52,523,731.00 to pay claims or expenses.

B:5, I (c). Of additional concern to the political subdivision members of the health trust and property liability trust may also be the inclination of its investment manager and chief financial officer to urge the board to be “more aggressive” in placing its investments and advising that “you are leaving money on the table” as indicated in LGC, Inc. meeting minutes, especially when this investment advice to take more risk occurred in year 2007. In addition to the length of maturity disparity, the pooled risk management program members’ funds are invested by the LGC, Inc. in accordance with its own investment policy that, while not expressly mandated by RSA 5-B, may be already more aggressive than it might otherwise be.

Another action undertaken by the LGC, Inc. controlled health trust involved its practice of inflating the premium rate charged to the political subdivisions that were members of its January pool. The LGC, Inc. engaged in a process for its rate setting that provided a projected premium rate to many, but not all, of its members several months prior to the final establishment of the actual rate to be charged for the upcoming coverage year. This preliminary rate was referred to as the guaranteed maximum rate (GMR). This GMR acted as an early warning or early assurance to the members that whatever the later actual rate was going to be, it would not exceed this GMR. This early GMR allowed the member municipalities, school districts and counties to continue with their own budget planning knowing that they would not receive a surprise spike closer to the passage of their own annual budget. However, those political subdivisions that operated on a calendar year budget cycle, *i.e.* members of the January pool, did not receive the benefit of such a notice. Instead they were only provided with an actual premium rate in October or November for their budget to begin January 1<sup>st</sup>. The LGC, Inc. board and management would arbitrarily “build in” an additional amount into the January pool’s actual premium, thereby affecting the alleged annual actuarially accurate premium amount. Such arbitrary increases to the

premium rates charged to January pool members violates the provisions of RSA 5-B:5, I (c) by inflating the amount of earnings flowing into, and retained by, the health trust in excess of what the actuarially based needs of the program were allegedly computed to be, in violation also of RSA 5-B:5, I (f) which requires the health trust to:

(f) Provide for an annual actuarial evaluation of the pooled risk management program. The evaluation shall assess the adequacy of contributions required to fund any such program and the reserves necessary to be maintained to meet expenses of all incurred and incurred but not reported claims and other projected needs of the plan.

This statutory reference also leads to discussion of another practice followed by the LGC, Inc. controlled health trust involving actions the board and management took relating to its self-selected “target” for the retention of excess earnings and surplus as its own net assets. It also involves their actions in utilizing what the LGC, Inc. and its entities call its annual rate setting process. The actual dollar figures that have been retained by the LGC, Inc. and its entities are depicted in tables appearing earlier in this decision. The use of a “target” number is commonplace in the insurance industry. It also seems to fluctuate among insurance-like entities, including pooled risk management programs, depending upon variations of risk factors from time to time that affect the calculations needed to set the desired or “targeted” amount of net assets as actuarially determined.

As previously stated, our RSA 5-B is unique. It also provides a “target” amount for pooled risk management programs operating in New Hampshire. That target is the excess of members’ earnings and surplus after permitted deductions are retained pursuant to RSA 5-B:5, I (c). Determining this excess is a matter of mathematics not magic. The only reasonable interpretation of the statute is that the components in the formula themselves must be reasonable. Setting a “target figure” does not appear

anywhere within the statute. A “target” is not a component of the standards of RSA 5-B:5, I (c). The target and the process used in connection with that target relates to the component referred to as “reserves” that does appear in the statute. And the hearing officer determines that these reserve amounts must be reasonable in light of the “golden rule” of reasonable statutory construction cited earlier<sup>31</sup> and the statute’s stated purpose to lower costs and provide anticipated returns to the health trust’s members. RSA 5-B:5:1.

The LGC, Inc. health trust “target” is an arbitrary number set by the LGC, Inc. board and obviously not a limit on its retention policy because it retained greater ratios in certain years despite substantially exceeding it. (See Table 1). The present target of the LGC, Inc. health trust, and it’s confessed target since the 2003 reorganization, is equivalent to a RBC ratio of 4.2, except when the board tacked on an additional RBC 0.5. In the life of the health trust there is insufficient evidence to determine the exact date on which the health trust decided upon its first target. But whenever that was we are told by its long time executive director, Andrews, that “we tried to have 20% of claims.” However the LGC, Inc. health trust originally used this 20% of claims figure as its target for net assets including additional reserves.<sup>32</sup> Prior to the LGC, Inc. reorganization in 2003 the health trust continued to operate with the 20% figure as its target, but as Table 1, above, shows it continued in operation for at least a decade while reporting a much more important figure. The more important figure was the actual amount of net assets or members balance it retained. In 1994 while its target was 20%, its actual retention of earnings and surplus was reported as 30.2%. The target figure had no impact on the health

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<sup>31</sup> “When one of several possible interpretations produces an unreasonable result, that is a reason for rejecting that interpretation in favor of another which would produce a reasonable result.” 2A Norman J. Singer & J.D. Shambie Singer, *Sutherland Statutory Construction* § 45:12 (7th ed. 2007).

<sup>32</sup> This reserve category is in addition to the claims reserve account held by the health trust to cover the cost of claims and of claims incurred but not reported (IBNR).

trust's actions. It ignores its own target. The health trust did not even return its own acknowledged excess to its members in that year. As discussed in detail earlier in this decision, the lowest level of net assets occurred in 1997 representing 7.6% of claims (RBC 1.22) and the health trust steadfastly maintained in a memorandum to its members and informed the public through the use of media at that time, that it was financially sound and in no danger of being unable to cover its claims and costs of administration. It nearly doubled its net assets the very next year to 14.23% of claims.

In 2002, just prior to the LGC, Inc. reorganization, its net assets were reported to be 14.2% of claims. The BSR witness Atkinson credibly testified that that percentage is the approximate equivalent of RBC 2.1. However, following the reorganization in 2003, the LGC, Inc. board and staff changed from a target expressed as a percentage of claims. They reportedly set a "new" target, utilizing the rate based capital (RBC) methodology. However, they set it at RBC 4.2, approximately twice the previous year's net assets. This result merely indicates that there really wasn't much new about the "new" target. Nor should much difference have been expected<sup>33</sup> because the board did not seek a pure RBC ratio but an RBC ratio that would support its rationale for accumulating an excessive amount of assets.

The newly expressed "target" set by the board using an RBC ratio proved no less illusory than the 20% of claims target did in earlier years. Using the several improper practices discussed in this decision above, the LGC, Inc. was soon reporting actual net assets in excess of its own self-selected "target" at levels in 2005 equivalent to RBC 4.5; in 2006 equivalent to RBC 6.0; and in 2007 equivalent to RBC 6.7. As before, the target figure had no impact on the health trust's actions. It ignored its own

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<sup>33</sup> The actuary, being the only outside actuary ever used by LGC and its entities since 1988, consulted with the same third party administrator, the same executive director, the same financial officer, the same strategic consultant, and the same health trust program manager before switching to an RBC modality from the more direct 20% figure they initiated as their target almost 25 years ago.

target. The health trust did not return even its own designated excess to its members as required by the statute.

These hard figures weigh heavily against and diminish both the weight and the credibility of evidence offered by witnesses called by LGC, Inc. and its entities and the sole witness called by respondent Carroll that the LGC, Inc. and its entities always “acted in the members’ interests.” These figures also contribute to my determination that the LGC, Inc. and its entities paid little attention, if any, to the requirement that funds in excess be returned to members of pooled risk management programs. Therefore by reason of the actions and practices undertaken by the LGC, Inc. and its entities detailed above, the hearing officer finds that those entities have violated the provisions of RSA 5-B:5, I (c). The hearing officer further finds that the LGC, Inc. and its entities are indebted to the members of the health trust and, to a lesser extent, to the members of the property liability trust, and that the LGC, Inc. is presently in control of funds in excess of the earnings and surplus of these two pooled risk management programs that a reasonable interpretation of the standards provided in RSA 5-B:5, I (c) would require be returned to each program’s members.

The Bureau of Securities Regulation alleges that the personal conduct of both Peter Curro, board member, and Maura Carroll, presently executive director, as individuals, violates the provisions of RSA 5-B. The BSR argues that Curro’s votes in favor of restructuring the LGC entities, to subsidize the workers’ compensation program, and to adopt a net asset target of an RBC of 4.2 prove his participation in the actions that violated RSA 5-B.

The evidence did show that Curro was on the board of NHMA Health Trust when it voted to merge with NHMA and NHMA Property/Liability in 2003. He was on the NHMA HealthTrust board

when it voted to contribute funds to establish a worker's compensation program a few years before the merger. He was on the LGC, Inc. board when it voted to set its RBC level at 4.2. Curro's individual votes as demonstrated by participation in the above board decisions for the health trust and then subsequently, LGC, Inc., are insufficient to find that he personally violated the standards of 5-B. The board, duly convened and acting as a unit, is made the representative of the company. Fletcher's *Cyclopedia of the Law of Corporations* § 392. The assent or determination of the members of the board acting separately and individually is not the assent of the corporation. *Id.* After reviewing the minutes of all of the board and committee meetings I cannot find by a preponderance of all evidence that he personally violated the standards of RSA 5-B. Therefore I determine that Curro, acting in an individual capacity, cannot be determined to have violated the provisions of RSA 5-B, and dismiss Counts I and II against him.

Similarly, BSR argues that Carroll failed to recommend corrective action for LGC's violations of RSA 5-B, including overcapitalization at an RBC of 4.2, failure to return excess net assets to members, returning surplus by discretionary rate stabilization, and utilizing a single third-party board and bylaws in a parent-subsidary structure. BSR argues that as an executive of LGC with management responsibilities, Carroll is personally liable for her participation in LGC's violations of RSA 5-B.

Carroll claims that as an executive director, she owed the duties of an agent only. She maintains that she implemented policies determined by the board of directors, and had no authority to deviate from them. Carroll admits that, acting at the suggestion of members, she recommended that the board transfer funds from the workers compensation program to health trust over a period of time and with interest payments. Despite her recommendation, the board rejected important aspects of it. The board, ignoring

her lawful and reasonable recommendation, made the ultimate decision, to execute a note evidencing an obligation but included neither a date certain nor any interest on principal payment. That act evidenced two things, that they never understood the true obligation to the members of the health trust program to protect those members' interests and, that Carroll lacked the power to override board of directors' decisions or to direct the board to reach a different conclusion.

The evidence presented indicates that Carroll did not have the ability to influence the LGC, Inc. board of directors. Under the LGC, Inc. bylaws Carroll, as an executive director, had a duty to carry out the policies established by the Board. As evidenced by the direct rejection of Carroll's recommendation to structure the promissory note with interest for the return of the \$17M to health trust, Carroll did not have sufficient influence over the board that she inherited from her predecessor who may well have had sufficient influence as a result of holding the position for 34 years. There was little other evidence provided by the testimony and exhibits to establish that she personally violated the standards of RSA 5-B. Therefore I find that Carroll has not individually violated RSA 5-B, and dismiss all allegations against her arising from RSA 5-B.

#### *RSA 421-B Securities*

Counts III, IV, and V, collectively referred to as the "Securities Counts," allege several violations of the New Hampshire Securities Act. Count III alleges that LGC, Inc. engaged in the offer or sale of unregistered securities in violation of the New Hampshire Securities Act, specifically, RSA 421-B:11. Additionally, Count III alleges that under RSA 421-B:6, LGC, Inc. is a broker-dealer who must be licensed to offer or sell securities, and that health trust, property liability trust, and workers

compensation trust are issuer-dealers who must be licensed. The BSR petition, as amended, also alleges that Carroll is an agent who must also be licensed to offer or sell securities. Count IV alleges that under RSA 421-B:26, III-a, Carroll and Curro either knowingly or negligently aided LGC, Inc. in selling unregistered securities. Lastly, Count V alleges that under 421-B:3, the respondents failed to disclose material facts in connection with the offer or sale of securities, and that the respondents engaged in actions that operate a fraud or deceit on their members by using member funds held in 5-B pools for non-pool purposes.

Preceding any analysis of alleged violations of the New Hampshire Securities Act, the instrument that the petitioner alleges is a security must be examined to determine whether it does in fact qualify as a security under the appropriate test. The BSR alleges that risk pool contracts, *i.e.* contracts for membership in the 5-B pools, also referred to as participation agreements, and NHMA LLC membership contracts, are securities and must be registered before being offered for sale or sold in New Hampshire. Yet, there has been no testimony provided nor exhibits admitted to support the claim that NHMA LLC membership contracts exist beyond the mere form indicating a membership fee must be paid by political subdivisions to NHMA LCC as a concomitant requirement for participation in a pooled risk management program. There is no other supplemental contractual writing evidencing additional terms of the membership relation and a lack of sufficient testimony establishing the relationship between a NHMA LLC member and that limited liability company. Therefore the hearing officer determines that the BSR has not sufficiently carried its burden on the fact that the membership fee agreement should be considered a “security.”

We look then only to the risk pool contracts, specifically, the 2000 and 2008 participation agreements admitted into evidence, to ascertain whether they are in fact securities under the appropriate test. To do so we look to the appropriate test to apply to determine whether the risk pool contracts are securities. Pursuant to the New Hampshire Securities Act, RSA 421-B:2, XX (a), an investment contract is considered a security, therefore, if a risk pool contract qualifies as an investment contract, it also qualifies as a security. Developed under Federal Securities law and adopted by the United States Securities and Exchange Commission, the analysis applied to determine whether an agreement constitutes an investment contract is the *Howey* test. *SEC v. W.J. Howey Co.*, 328 U.S. 293 (1946).

Under the *Howey* test, “an investment contract, for purposes of the Securities Act, means a contract, transaction or scheme whereby a person invests his money in a common enterprise and is led to expect profits solely from the efforts of the promoter or a third party, it being immaterial whether the shares in the enterprise are evidenced by formal certificates or by nominal interests in the physical assets employed in the enterprise.” *SEC v. W.J. Howey Co.*, 328 US 293, 298-99 (1946). Thus, the four basic elements of the *Howey* test are: (1) the investment of money; (2) in a common enterprise; (3) with the expectation of profits; and (4) to come solely from the efforts of others. Since the *Howey* test requires a satisfaction of all four elements, if one element cannot be satisfied, the risk pool contracts are not deemed securities.

Reviewing the third element of *Howey*, “expectation of profits,” under the preponderance of the evidence offered at hearing the political subdivisions that enter into risk pool contracts do not do so with the expectation of profit. Rather, they enter into these contracts to acquire and use insurance products and insurance coverage, such as healthcare, dental, workers compensation, and property liability and to

obtain risk management services. A contract is a security where the purchaser is motivated to invest by the potential for profits, not solely by a desire to consume the product purchased. The United States Supreme Court in *United Housing v. Forman* addressed this “profit motivation” aspect and cited to the definition of “profit” in this context, explaining that:

The touchstone is the presence of an investment in a common venture premised on a reasonable expectation of profits...By profits, the Court has meant either capital appreciation resulting from the development of the initial investment...or a participation in earnings resulting from the use of investors’ funds...In such cases, the investor is ‘attracted solely by the prospects of a return’ on his investment...By contrast, when a purchaser is motivated by a desire to use or consume the item purchased...the securities laws do not apply.

*United Housing v. Forman*, 421 U.S. 837, 852-53 (1975).

In *Forman*, participants in a rental-housing program were required to buy shares of “stock” in order to lease an apartment in the rental housing facility. *Forman*, 421 U.S. at 842. Although the term “stock” was employed, in a traditional sense, the purchase was comparable to a deposit on the rental home. *Id.* Ascertaining whether the “stock” was considered a security, the United States Supreme Court noted that, “form should be disregarded for substance and the emphasis should be on economic reality.” *Tcherepnin v. Knight*, 389 U.S. 332, 336 (1967); *see also Howey*, *supra*, at 298. The U.S. Supreme Court disregarded form for substance concerning the “stock” purchased and found there was no “doubt that investors were attracted solely by the prospect of acquiring a place to live, and not by financial returns on their investments.” *Forman*, 421 U.S. at 853. Additionally, the U.S. Supreme Court concluded that even where tenants received a rent rebate for the expenses of the housing facility, the purchaser was still motivated by a desire to use or consume the item purchased. *Id.*

Similar to *Forman*, the question here is whether the purchaser of a risk pool contract does so with the expectation to earn a profit or to use or consume the insurance product, service, or coverage purchased. As addressed first by *Howey*, and later *Tcherepnin*, form should be disregarded for substance and the economic reality of the transaction must be analyzed. *Tcherepnin v. Knight*, 389 U.S. 332, 336 (1967); see also *Howey*, supra, at 298. LGC, Inc. offers pooled risk management programs to political subdivisions within the state of New Hampshire as an alternative to traditional insurance products. LGC, Inc. pools the political subdivisions' premiums that are then invested and managed by LGC, Inc.'s professional staff and retained consultants. The agreement made between LGC, Inc. and its members is a contractual one, where a participating municipality is asked to provide a contribution, in the form of a premium, in exchange for coverage in a pooled risk management program. The contributions are based on the number of employees a political subdivision has and what the medical claims experience has been for that subdivision, factors that typically drive insurance programs not investment decisions. Additionally, each of the participating agreements is for a finite period of time, sometimes only one year.

Moreover, the language of the risk pool contracts neither states nor implies that an investment is being made by the political subdivision, but that insurance coverage is being purchased. For example, the 2000 participation agreement for the health trust contracts with municipalities to become members of the then NHMA, Inc. and to receive the benefit of the programs offered through the health trust. The 2000 "Resolution for Participation in the Multi Year Rate Guarantee Program" contract for the property liability trust offers incentives for joining, such as: a return of 2 ½% of the renewal contribution for coverage period of July 1, 1997 to June 30, 1998, a 5% reduction in trust rates from July 1, 1998 to June 30, 1999, and no increase in trust rate for July 1, 1999 to June 30, 2000. Further, the "Resolution for

Participation in the Multi Year Rate Guarantee Program” is distinguished from offering a profit because the contract stresses that the reduction and guarantees are with respect to rates and not the total amount of contributions, which may increase or decrease depending upon underwriting exposures. The contracts for pre-determined rates for future years are incentives to join a pooled risk management program to acquire insurance coverage or obtain risk management services, they do not constitute an advertisement to earn profit from an investment.

Additionally, the 2008 participation agreement contracts with municipalities to become members of NHMA LLC as a provision to the LGC, Inc. bylaws Section 3.7, and to participate in either of the following pooled risk management programs: health trust, property liability trust, workers compensation trust, and unemployment benefits. Addendum 4 to the 2008 participation agreement includes a “Multi Year Rate Guarantee Program” for the property liability trust for the periods of July 1<sup>st</sup> to June 30<sup>th</sup> of 2009, 2010, and 2011, where the rates are predetermined but if the underwriting exposures are reduced or increased for a member, then the amount of contribution is adjusted accordingly. Similarly, Addendum 5 includes a similar contract for the workers compensation trust for a “Multi Year Rate Guarantee Program,” where the rates are predetermined but if the underwriting exposures are reduced or increased for a member, then the amount of contribution is adjusted accordingly. Lastly, Addendum 7 includes a “First Rate Package Pricing Agreement” for members who are enrolled in the property liability trust, workers compensation trust, and the health trust, that contracts with members to receive a credit against the price of protection provided by the workers compensation trust and further, if members additionally participate in the “TRiM Program,” they receive an additional credit to the previously mentioned credit from the workers compensation trust. Again, the contracts for multi-year pre-determined rates are incentives to join a pooled risk management program and acquire

insurance coverage or obtain risk management services, they are not an advertisement to earn profit from an investment.

Likewise, the LGC, Inc. bylaws highlight the purpose of the organization, to provide insurance to political subdivisions by managing healthcare, property-liability, and workers compensation risks. The participation agreements do not advertise that a political subdivision is paying money into an investment vehicle from which they should expect a profit or in the case of a not-for-profit pooled risk management program, earnings. Rather, reviewing the language of the documents, a participating political subdivision would believe that they are paying a contribution in exchange for a risk coverage program from which they may receive excess earnings and surplus, not paying into an investment. The argument made that dividends or rate credits are a form of profit that satisfies the “expectation of profit” element of *Howey* is addressed later in this decision.

As testified to by Curro, at no time did he, as a participating member, have the intent that the purchase of insurance would be an investment in the health trust or LGC, Inc. Furthermore, Curro testified that that he did not have an expectation that the purchase of insurance through the health trust or LGC, Inc. was for profit. Attorney Loughlin, an experienced municipal law practitioner, also echoed a similar sentiment during his testimony, that to the best of his knowledge, municipalities have a need to buy health insurance for their employees and that is why they go into the marketplace, not to invest town funds. Lastly, Andrews testified that he did not think political subdivisions believed that LGC, Inc. was an investment vehicle, rather that it was held out as an insurance vehicle. Applying the preponderance of the evidence standard, political subdivisions were attracted “by the prospect of acquiring” an insurance product or coverage, “not by financial returns on their investments.” *Forman*, 421 U.S. at 853.

The petitioner has further argued that an “expectation of profit” existed in the promise of dividends or rate credits for future participating years. A return of profits can take the form of capital appreciation, dividends, or a stated fixed return to investors. Additionally, the one commonality of profits is that they all essentially involve a return of money, whether through dividends or an offset to another necessary cost. However, the profit that *Howey* refers to is the profit to the person who is putting money into the enterprise, not the profit that the company itself receives from its ongoing investment or operating activities.

Two cases are instructive in this matter, *Dryden* and *Collins*, where the issue at hand involved whether insurance policies could be characterized as securities. *Dryden v. Sun Life Assurance Company of Canada*, 737 F.Supp. 1058 (S.D. Ind. 1989); *Collins v. Baylor*, 302 F.Supp. 408 (N.D. Ill. 1969). Both courts held that the insurance policies were not securities because the purchasers did not expect a profit by way of [investment] “dividends” returned to the members. *Dryden*, 737 F.Supp. at 1063; *Collins*, 302 F.Supp. at 411. As described in *Dryden*, “under a participating life insurance policy issued by a mutual insurance company, the ‘dividends’ paid are in fact a return of excess premiums paid in by the policyholder, rather than a share of the company’s investment profits.” *Dryden*, 737 F.Supp. at 1062. The dividends are not “profits as in the case of an ordinary corporation.” *Dryden*, 737 F.Supp. at 1063.

*Collins* discussed that it “is not the expectation of anyone buying these kinds of [insurance] policies that they are going to be sharing in the profits of a company.” *Collins*, 302 F.Supp. at 411. The “so-called dividends are, in reality, not dividends, but in a mutual insurance company are merely a return to policyholders of the unearned, that is, unused portion of the premium paid in.” *Collins*, 302 F.Supp. at 411.

In the case of LGC, Inc., until expended to pay claims or operational expenses, most of the funds contributed by the members are invested in the market. LGC, Inc. is similar to standard insurance companies in that they engage in investment practices through a third party. LGC, Inc. employs both an investment manager to handle the investment portfolio as well as an investment advisor who supervises the investment manager. Any dividends that are returned to the members are not a share of LGC, Inc.'s investment profits, as one would typically characterize the profits of a private corporation. Rather, they are "merely a return" to the political subdivisions of the "unused portion of the premium paid in," which has usually been invested in the market to the benefit of the members. Collins, 302 F.Supp. at 411. The LGC, Inc. bylaws, 5.1 and 5.2, states that an excess in earnings and surplus may be returned to members. Where a property liability trust informational release statement utilizes the word "dividends," it does so to describe a return in member premiums, not profit. As Attorney Murphy testified to, "dividends" in essence, are excess premiums, a term of art commonly used in the insurance world. In fact, LGC, Inc. returned dividends to the Town of Warren in two instances, one for the period of 1990-1995, and the other for the period 1994-1996. Additionally, as Keeffe testified, in the years 2002-2003, surplus from the property liability trust was returned to members in the form of dividends. Again, these returns were not profits on investments made by the political subdivisions, but a return of surplus, thereby, constituting excess premium.

By contrast, a rate credit that is issued to a political subdivision is distinguished from a dividend in that it is not a return on excess premium, but more analogous to a rebate for future participating years. As Andrews testified, rate crediting was employed in 2008 as a substitute to issuing cash dividends to political subdivisions. In the past, LGC, Inc. has advertised that a risk pool management program invests premiums and the profit resulting from third party investment practices is used to reduce rates for the

participating political subdivisions. It is also noted in LGC, Inc. materials that “members prefer that funds be returned to them in the form of rate decreases over subsequent rating periods.” These above examples are similar to *Forman*, where an informational bulletin distributed to prospective residents advertised that “if rental charges exceed expenses, the difference will be returned as a rebate.” *Forman*, 421 U.S. at 853-54. The US Supreme Court found that “nowhere does the Bulletin seek to attract investors by the prospect of profits.” *Forman*, 421 U.S. at 854. These rebates were not the “kinds of profits traditionally associated with securities.” *Id.*

Here, we have a similar case of rate credits being advertised and offered to prospective participating political subdivisions. Yet, these rate credits do not “seek to attract investors by the prospects of profits.” *Forman*, 421 U.S. at 854. Consequently, when employing the rate crediting process, surplus is not credited just for the following year, but over multiple years into the future for those political subdivisions that choose to acquire insurance through LGC, Inc. for that extended period. The political subdivision is still motivated by the desire to use or consume the product purchased, whether or not a rate credit happens to be incidental to participation in a pooled risk management program. Rate credits issued to a political subdivision are not the “kinds of profits traditionally associated with securities” and they fail to satisfy the “expectation of profit” element of *Howey*. *Forman*, 421 U.S. at 854. Considering that the expectation for entering into the risk pool contracts is for the consumption of a product rather than an expectation of profit, risk pool contracts fail to satisfy this element of the *Howey* test, and therefore, are not securities.

Since the *Howey* test requires a satisfaction of all four elements, and the pooled risk management program contracts fail to satisfy at least one of these *Howey* elements, the “expectation of profit,” we

need not continue the analysis of the other three *Howey* elements to make a determination. Under the *Howey* test, these contracts are found not to be investment contracts for the purposes of this securities analysis.

Since the RSA 5-B pooled risk management participation agreements do not constitute securities, no further discussion is necessary of the alleged violations of RSA 421-B by the respondents included in the remaining Counts III, IV and V as they require the offering and selling of securities. Concluding in this manner, the hearing officer finds no violations of any provision of RSA 421-B. Therefore the complaints of violations of any provision of RSA 421-B contained in the BSR petition as amended, are dismissed against the LGC, Inc. and all of its entities and dismissed against the two remaining individuals named as respondents.

There are numerous other administrative practices that are maintained by the LGC, Inc. in exercising its control over members of the health trust pooled risk program that may not directly violate the statutory provisions addressed by this decision but should, in light of this decision and accompanying order, be considered in any discussions regarding changes in governance and financial management. Several are noteworthy and reflect the irony common to the operation of the LGC, Inc. and its entities. The first relates to a series of actions that contradicts a purported rationale for some of its reorganization actions. Its consultant, Emery, explaining the need for reorganization and defending its need to maintain LGC, Inc. controlled programs in the market against a competitive rival, Primex, testified that, "Monopolies are scary things." Yet the LGC, Inc. makes decisions related to its own health pooled risk management programs that are monopolistic in design. These include: (1) mandatory membership in another of its entities, the NHMA, LLC; (2) contractual "lock out" provisions preventing

program members which have left the program from being able to rejoin the program without special authorization of the board of directors for a period of two years; (3) entering into multiple year agreements with Anthem Blue Cross Blue Shield which prevent political subdivisions with over 50 employees, except Manchester and Nashua, from being able to obtain health insurance products from Anthem without joining the LGC, Inc. health trust; and (4) employing private marketing practices to eliminate competition that it once declared unethical; in combination with the previously mentioned dilution and control in governance.

A second practice that adds irony to the operation of LGC, Inc. and its entities relates to the testimonial profession of its witnesses that its purpose is to serve the members' interests, which implies those of the health trust members. The following LGC, Inc. practices and actions do not reflect the testimony: (1) informing its membership after consideration of and after decisions regarding major actions affecting each member, as in its reorganization and the subsidizing of a separate trust; (2) continually renaming line items in its financial reporting and using vague terms that shield the actual purpose of the transaction; (3) arbitrarily deciding to eliminate the provision of certain types of information to members, as in "condensing" minutes of a critical board meeting crucial to the operation of the conglomerate, and omitting the distribution of detailed year end financial reports of the financial transactions of the LGC, Inc. "parent" to the political trust members because it would make the financials "too long"; and, (4) preliminarily circulating the minutes of board and committee meetings to management team members to permit editing before providing the minutes to the actual board or committee members for approval at the bodies' next meeting months in the future.

A third practice reflects an irony related to its investment policy. The LGC, Inc. is purportedly the state's largest representative of municipalities and it purportedly operates one of the largest, if not the largest, insurance-type pooled risk management programs in the country. Its board and staff witnesses testify that they fully appreciate the responsibility of protecting the members' funds and employ conservative practices to have sufficient reserves on hand. However, credible testimony was offered that almost 20% of its portfolio of investments fell outside the parameters established by existing statutes that limit the nature of investments of New Hampshire municipalities and that limit the nature of investments of other insurance entities. No regard appears to have been made to investment limitations despite the LGC, Inc. board being largely comprised of municipal officials and governing programs that operate like insurance entities.

A fourth practice that has the opposite effect than that declared in testimony relates to board of directors' membership. While emphasizing the representativeness of its 31 member board of directors and its close involvement in the process of decision-making relating to the health trust, several characteristics of membership and process minimize the effectiveness of either. These include: (1) the manner of appointment of individuals to fill unexpired terms of elected members; (2) the size of the board of directors resulting in the inability to fill all 31 positions of the board and the scheduling and duration of the meetings more convenient to staff than members that results in only 6 or so elected officials being present at most meetings of the board of directors; (3) the relatively few decisions made by recorded vote; and (4) the characterization of dissident comments made by individual board members reflected in any minutes or legislative testimony as reflective of "robust" discussion, when read in context they appear more reflective of admonitions or expressions of conscience by professional public

managers, public employees and elected officials that are lost in the forward advance of the conglomerate interest.

## ORDER

For the reasons appearing in the narrative decision above and provisions below it is hereby ordered as follows:

(In the provisions of this order, the Local Government Center, Inc., Local Government Center Health Trust, LLC, and the Local Government Center Property-Liability Trust, LLC are collectively referred to in this order as the “LGC, Inc.” unless otherwise required to be specified.)

1. No later than 90 days from the date of this Order, the Local Government Center shall organize its two pooled management programs into a form that provides each program with an independent board and its own set of written bylaws.
  
2. Failing timely re-organization as ordered above in § 1, the LGC, Inc. is deemed to continue in violation of RSA 5-B, and this order, including the order to cease and desist, and shall, pursuant to the authority extended in RSA 5-B:4-a, I and II, be penalized by forfeiture of the statutory exemption from the State’s insurance laws and of the exemption from state taxation granted pursuant to RSA 5-B:6 as it, nor any existing insurance program as presently operated

by LGC, Inc. shall be deemed to be a “pooled risk management program” as defined by RSA 5-B.

3. The remainder of this order shall be construed to apply to the risk pool management programs currently known as Local Government Center Health Trust, LLC, and the Local Government Center Property-Liability Trust, LLC however they may be organized in the future.
4. The Local Government Center’s risk pool management programs, however they may be organized in the future, shall not require participating members to join or participate in any organization that requires the payment of dues for membership in said organization, nor shall any of the risk pool management programs require members to pay fees, premiums or costs for services not specifically identified and approved in RSA 5-B.
5. The parties have litigated this dispute by agreement based upon the 2010 year-end audited financial statements and this Order is issued, contingent upon said agreement, based upon those financial statements. Absent an express agreement that the BSR and the LGC, Inc. entities agree to update the figures appearing in those statements, the figures and amounts stated herein shall govern.
6. The Local Government Center’s Health Trust risk pool management program holds \$86,781,781.00 in total net assets from earnings and surplus as an additional reserve amount beyond other amounts that have been set aside to cover costs of administration

and claims. The program holds no funds for costs of reinsurance because it abandoned purchasing reinsurance effective June 30, 2010. This amount of earnings and surplus it retains, consistent with the narrative decision, is unreasonably high representing approximately 24% of claims. Again, consistent with the narrative decision and specifically relying on historic net asset figures, historic actual RBC ratio's, contradictory testimony and the arbitrary assignment of risk percentages that can invade risk based capital (RBC) calculations which in turn can yield a divergent result depending upon the underlying stochastic model utilized, the amount of excess of earnings and surplus declared currently held by LGC is \$33,200,000.00. This amount is based upon a calculation that limits LGC to a reserve, in addition to its costs of administration and claims, equal to 15% of claims, a straightforward method of reserve calculation familiar to both the BSR and the LGC. This amount shall be returned to members of that program in proportion to each member's contributions to that standing amount of earnings and surplus.

7. The return of the \$33,200,000.00 amount shall not be affected by the cost of returning to the practice of purchasing reinsurance by the Local Government Center's Health Trust which practice is so ordered immediately.
  
8. The Bureau of Securities Regulation and the Local Government Center shall confer and within 30 days from the date of this Order shall submit to the undersigned hearings officer an agreed upon plan for the return of this \$33,200,000.00 excess amount in cash to

members who participated in the Local Government Center's Health Trust risk pool management program at any time after June 14, 2010. A negotiated plan may include prospective returns of cash or its equivalent. Failing the submission of the agreement within 30 days from the date of this Order, the Local Government Center's Health Trust risk pool management program, in whatever form it may be organized, shall return the \$33,200,000.00 excess amount in cash to members that participate in the Local Government Center's Health Trust risk pool management program on the date of this order, no later than September 1, 2013 in proportion to the premiums paid by said members.

9. These proceedings have revealed numerous tangential issues that relate to the continued existence of pooled risk management programs enabled by RSA 5-B that demand the responsible attention of the legislature and the BSR. In future years until such time as pooled risk management programs involving captive markets, such as all political subdivisions within the state, may be further addressed in that manner, a reasonable amount of earnings and surplus that may be retained by the Local Government Center's Health Trust, however it may be organized, which the hearing officer determines, consistent with the narrative decision and a reasonable interpretation of RSA 5-B:5, I (c), as applied to the issues presented by these proceedings, is the equivalent of fifteen percent (15%) of claims or an RBC 3.0 as determined by the BSR, whichever is the less, based upon the year end audited financial statement of the Local Government Center's Health Trust risk pool management program.

10. All amounts in excess of fifteen percent (15%) of claims or in excess of an RBC 3.0 actuarial analysis which must be approved by the BSR consistent with its supervisory authority and which it shall exercise in good faith, or the lesser of the two calculations, shall annually be returned in the form of cash, dividends or similar cash equivalents to members. Until such time as the legislature may address pooled risk management programs by legislation or regulatory rules, the BSR, consistent with its existing supervisory powers under RSA 5-B which it shall exercise in good faith, may upon prior written notice of at least one (1) year impose a higher limit or different methodology for calculating required net assets that may be retained as earnings and surplus not in excess pursuant to RSA 5-B:5, I (c) as long as said methodology is specifically based upon a generally accepted actuarial analysis.

11. The parties did not propose a means of calculating the required net assets for the Local Government Center's other risk pool management programs except to the extent that the Local Government Center, through the testimony of its chief financial officer, admitted that it holds approximately \$3.1 million in excess surplus in its Property and Liability program. The Respondents also did not attest to the use of an actuarially based means of determining the required net assets for this risk pool management program. It is Ordered that the Bureau of Securities Regulation and the Local Government Center shall confer and within 30 days from the date of this Order shall submit to the undersigned hearings officer an agreed upon plan for the return of the \$3.1 million surplus in cash to members who participated in the Local Government Center's Property and Liability risk pool management program at any time after June 14, 2010. A negotiated plan may include prospective returns of cash. Failing agreement,

the Local Government Center's Property and Liability risk pool management program, in whatever form it may be organized, shall return the \$3.1 million surplus in cash to current members of the Local Government Center's Property and Liability risk pool management program on the date of this order, no later than September 1, 2013 in proportion to the premiums paid by said members.

12. In the future the Local Government Center's Property and Liability risk pool management program, however it may be organized, shall utilize a generally accepted actuarial analysis to determine its required net assets and shall annually return any excess surplus in cash, dividends or their equivalents to members. The generally accepted actuarial analysis must be approved by the BSR consistent with its supervisory authority which it shall exercise in good faith.

13. The Local Government Center Property Liability Trust, LLC, however it may be organized in the future, shall re-pay the \$17.1 million subsidy to the Local Government Center Health Trust risk pool management program, however it may be organized, no later than December 1, 2013. Said payment shall terminate and shall satisfy any obligation contained in a note of similar amount executed on June 2, 2011. The funds to make this re-payment may be borrowed from an independent entity at commercially reasonable terms in consultation with the Bureau of Securities Regulation in the exercise of its supervisory powers which shall be exercised in good faith.

14. Funds received by the Local Government Center Health Trust in re-payment of the subsidy, to the extent they constitute amounts in excess of the earnings and surplus of the Local Government Center Health Trust risk pool management program as reasonably determined and expressed above in § 9, shall be returned to members consistent with RSA 5-B:5, I (c).
  
15. Within 90 days of the date of this order, the Local Government Center, Inc. shall cause Local Government Center Real Estate, Inc. to convey to the Local Government Center Health Trust risk pool management program and the Local Government Center Property Liability pooled risk management program shares in the ownership of the real estate corporation in proportion to their initial in kind contributions and subsequent cash contributions. To the extent the parties agree to consider a decision by the Local Government Center Property Liability pooled risk management program to forego ownership of its proportionate shares in deference to the repayment of the subsidy, *see* § 13 above, they may do so by agreement. The realty corporation, in proportionate share, will then be managed by the respective boards of directors of the risk pool management programs for the benefit of those programs.
  
16. In light of other provisions of this decision and order, no fines as referenced in RSA 5-B:4-a, VII (a) are assessed against any respondent.
  
17. To the extent that this order requires the return of funds or property in the alternative, this order requires compliance with these provisions as restitution or disgorgement pursuant to RSA 5-B:4-a, VII (b).

18. The Local Government Center, Inc., Local Government Center Health Trust, LLC and the Local Government Center Property Liability Trust, LLC are found jointly and severally liable for the costs of the investigation in this matter, and all related proceedings, including reasonable attorney fees, pursuant to RSA 5-B:4-a, V and are ordered to pay same. The BSR and these respondents shall confer within 30 days of the date of this order to determine an agreed upon amount of costs to be paid. Failing agreement, the parties shall agree upon a mediator to submit the question of costs and fees as addressed in RSA 5-B:4-a due to the office of the secretary of state and failing the issue being successfully mediated within 45 days of the date of this order, the BSR shall submit to the hearing officer within 45 days of the date of this order its itemization of costs for which it seeks reimbursement.
  
19. All parties and counsel and staff shall continue to preserve and maintain all electronic communications that were transmitted from the hearing room and related to the proceedings being conducted therein which were distributed via any and all means of electronic social networks, including but not limited to Facebook, Twitter, Linked-in, or other group bulletin boards or personal or entity websites, until such time as these proceedings have ended or until further order.
  
20. All motions to dismiss and for summary judgment, are hereby declared moot consistent with this narrative decision and order.

21. In light of the foregoing, the Secretary of State's September 2, 2011 Cease and Desist Order is hereby made permanent.

So Ordered, this 16<sup>th</sup> day of August, 2012.



Donald E. Mitchell Esq., Presiding Officer

Attachment A – Joint Exhibit 2 Timeline of Organizational Event

Service List:

cc: Jeffrey D. Spill, Esq.  
Earle F. Wingate, III, Esq.  
Kevin B. Moquin, Esq.  
Eric Forcier, Esq.  
Adrian S. Laroche, Esq.  
William C. Saturley, Esq.  
Brian M. Quirk, Esq.  
David I. Frydman, Esq.  
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Joshua M. Pantesco, Esq.  
Mark E. Howard, Esq.  
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Roy W. Tilsley, Jr., Esq.  
Stephen M. Gordon, Esq.  
Benjamin Siracusa Hillman, Esq.  
Christopher G. Aslin, Esq.  
Kimberly Myers, Esq.

